Abt Associates Inc.

P: AFR/037.10D
PN-ABT-966

Pls pass to Tyler for Central Files

July 26th, 1994

Ms. Penny Farley
Chief Technical Officer
Privatization and Development Project
USAID/PRE
515 22nd Street, NW
Washington DC, 20523

Dear Penny:

Please find enclosed a revised preliminary draft of ~~the paper entitled:~~ "African Privatization: Recent Lessons Learned". Unfortunately, there seems to have been a problem with the reproduction of the earlier version and some pages may have been missing from your copy. In addition, this version now includes a draft of the Executive Summary and an expanded Bibliography.

Please do not hesitate to contact me if you have any questions. I can be reached on vacation during the next tens days at telephone number 508/922-4692 in northern Massachusetts.

Best regards,

Anthony A. Davis /cg

Anthony A. Davis

enclosure

cc: [redacted]
IPG/Price Waterhouse

PN-ABT-964

AFRICAN PRIVATIZATION: RECENT LESSONS LEARNED

Preliminary Draft -- II

(July 20, 1994)

Prepared for:

United Agency for International Development

Privatization and Development Project
USAID Contract No. DPE-0016-Q-00-1002-00

Prepared by:

Price Waterhouse (International Privatization Group)
and
Abt Associates Inc.

EXECUTIVE SUMMARY

I. Introduction

In this report, the experience gained in conducting a seven-country activity sponsored by USAID's Office of New Initiatives (ONI) in the Africa Bureau is summarized. These countries included: Senegal; Cote d'Ivoire; Cameroon; Ethiopia; Mozambique; Zambia; and Madagascar. In addition, a brief review of general privatization experience in Sub-Saharan Africa is presented in order to provide an indication of whether privatization has been or is likely to be successful in the region. Thereafter, some key principles and lessons learned regarding the design and implementation of privatization programs are highlighted. These are divided into four topic areas: (i) privatization program design and implementation; (ii) enabling environment; (iii) governance and transparency; and (iv) the role of donors. Finally, a number of areas in which USAID could have particular comparative advantage in providing privatization-related assistance in the future are identified. While neither an exhaustive nor mutually exclusive list, these areas of opportunity include: (i) institutional framework; (ii) broadening share ownership; (iii) compensating the losers; (iv) legal aspects of governance; and (v) infrastructure industries.

Overall, it is concluded that while privatization experience to date in Africa has not been overwhelmingly positive, there is reason to believe that appropriately designed programs and implementation assistance in the mid-1990s can have a significant impact on the success of privatization. Moreover, privatization programs are becoming a more widespread phenomenon in Sub-Saharan Africa and the base of empirical experience from which to draw is substantial relative to that of the early to mid-1980s. As a result, donor assistance to Africa should continue to emphasize privatization as a component of broader economic reform. USAID's strategic focus on such themes as building democracy and encouraging broad-based economic growth can be well served by privatization-related initiatives.

II. Summary of ONI Activities

In October 1992, USAID's Office of New Initiatives (ONI) in the Africa Bureau commissioned an assessment of the privatization potential and related governance issues in selected African countries through a buy-in to the Privatization and Development (PAD) project. The purpose of the ONI activity was to provide a catalytic role in advancing privatization programs and/or transactions in selected African countries and to better define country-level privatization assistance programs.

The criteria for deciding the country in which the ONI buy-in would operate evolved over time. The following criteria emerged and were applied: (i) the project activity must have the potential to have a catalytic role, within the budget available, in each country selected; (ii) the ONI activity could only be undertaken once in a given country, thereafter the Mission (or another entity) would have to fund continuing support for the privatization initiative assisted by ONI; (iii) the range of countries should be representative of a cross-section of Sub-Saharan Africa; (iv) the

AID Mission in the country must request the ONI assistance; and (v) the activity could be lodged at any level such as program design, Mission strategy development or transactions support, as long as the four other selection criteria were met.

Seven countries were selected: Senegal; Cote d'Ivoire; Cameroon; Ethiopia; Mozambique; Zambia; and Madagascar. The activity in each country varied in terms of scope and level of effort.

- *Senegal*: There were two phases to this activity. They were aimed at assisting with the privatization of SONACOS, a major producer of groundnut related products and the second largest industrial concern in the country. The ONI activities developed a framework for privatizing SONACOS and in the second phase, produced a privatization strategy, recommendations for restructuring and a valuation of the company. The activity clarified a number of critical issues with regards to the privatization of SONACOS, and helped to generate momentum for the privatization process which had been languishing for a number of years.

- *Cote d'Ivoire*: In December 1992, the Mission requested that the ONI project conduct an overview and assessment of the privatization program in Cote d'Ivoire and recommend what type of assistance program, if any, the Mission should pursue. The ONI team reviewed the overall policy, institutional, regulatory and legislative framework governing the privatization program, examined the track record with regard to transparency and other issues related to governance, and reviewed the experience with enterprises that had been recently privatized. The ONI team concluded that it was not an opportune time for the Mission to commence a major privatization assistance program, but that the Mission should revisit the issue in the next 12 to 18 months.

- *Cameroon*: In July 1993, the Mission requested ONI to fund technical training for members of the Privatization Sub-Commission in Cameroon. A reconnaissance mission to identify training requirements and familiarize the trainers with Cameroon's privatization program was conducted in August 1993. The seminar, which took place in November 1993, was successful in terms of generating consensus on key privatization issues and strategies. Substantial publicity was generated during the process, including interviews on television and radio, and daily press write-ups on the proceedings. Whereas the impact of the assistance was high in terms of creating visibility and public support for the privatization program and essentially renewing interest, problems identified remain unresolved. Thus, USAID created momentum and visibility, but unfortunately was then unable to follow-up due to the closing of the Mission.

- *Ethiopia*: ONI was asked to provide the Ethiopian Ministry of Industry (MOI) with the services of a short-term technical specialist to train selected MOI-designated individuals in financial analysis and valuation techniques, and to assist MOI in carrying out valuations of the four pilot group enterprises slated for privatization. At the conclusion of the assignment, the ONI team also provided some suggestions to the Mission as to how it might best support the government's privatization initiatives in the future. These mainly related to the institutional framework, and processes and procedures for carrying out the privatization program. At the end of the training program, the MOI participants were capable of carrying out basic valuations themselves. In addition, the program was successful in its goal of assisting the MOI to value the enterprises in the pilot group, and played a catalytic role in encouraging MOI (and the Government in general) to move forward with privatization.

- *Mozambique*: Assistance was requested from the ONI activity to provide continuing support for the liberalization of the trucking industry and privatization of the four main parastatal trucking companies. USAID and the World Bank had been assisting with the technical design of the sector's liberalization and privatization program. However, the donors felt that a critical step in building momentum for the implementation of the program was to raise key issues and develop consensus among major stake holders in the trucking sector via an interactive workshop/seminar. ONI was asked to plan the workshop and prepare key materials. These included papers on industry regulation, trucking company privatization and the enabling environment for the trucking sector, as well as support in the development of the seminar's agenda and participant list.

- *Zambia*: To support the Mission and the Zambia Privatization Agency in its privatization efforts, ONI was requested to fund a "desk study" on lessons learned in privatization worldwide. Specific examples of countries' experiences which could be adapted by Zambia were to be emphasized. The rationale for the ONI assistance was a perception in Zambia that lessons learned elsewhere in the world needed to be understood in order to design a better, formal program of privatization in Zambia. Drawing on worldwide experiences in several topic areas, the report presented implications and recommendations for the Zambia privatization program. The report has been a valuable "primer" for the Zambian privatization program and has been distributed widely. It has proved to be a high impact form of privatization assistance.

- *Madagascar*: ONI assistance was initially approached to provide an overall review and assessment of the privatization program in Madagascar and to recommend what form of assistance the USAID Mission might provide. However, it soon became apparent that the Government's suspension of the privatization program and the lack of progress with creating an enabling environment for private sector development, meant that the ONI team should not focus exclusively on privatization but instead broaden the scope of analysis. Consequently, the ONI team assisted with the design of a project, entitled Business Enterprise Services and Technology (BEST), which is intended to address perceived legal and regulatory constraints to private sector development and to improve the quality, availability and delivery of business services to the private sector. The assistance resulted in the preparation of a report which formed the basis of the Mission's Project Identification Document (PID). The BEST project has subsequently been designed and the Request for Proposals are expected to be issued during 1994.

III. Privatization Experience in Sub-Saharan Africa

The reform of the public enterprise (PE) sector and privatization have been key elements in structural adjustment programs in Sub-Saharan Africa since the early 1980s. Much of the early emphasis was placed on reform of public enterprises. However, greater reliance on privatization has been manifest in recent years.

The early African experience, however, with privatization was not an overwhelming success. Many observers noted the large gaps between privatization rhetoric and actions, the slow pace of implementation, and its marginal effects on efficiency and growth. Programs were poorly designed, lacked transparency and sufficient political support, and often employed only a narrow range of privatization mechanisms.

There are a few countries in Africa which have had some degree of success with privatization. The definition of "success" is relative and integrally linked to the objectives of a given privatization program. Several of the early privatizations in Africa succeeded in stemming fiscal burdens (mainly through liquidations); a few raised revenue for Government through sales proceeds, although many argue assets were under-priced; virtually none of the privatizations totally removed economic distortions in the privatized company's sector (many PEs were sold to "insiders" and/or came with special deals/protection); and, with regard to whether overall economic efficiency and growth have been generated by privatization, it is difficult to make a determination as there is little post-privatization monitoring and the track record is not long enough.

The number of countries that have adopted formal programs of privatization has increased substantially in the last few years. The privatization phenomenon in Africa is now widespread, is central to donor relations and conditionality, and provides a core component of the political platform of many of the current governments (albeit still rhetoric in some cases).

Lessons learned to date suggest that the broader context for privatization, such as creation of an enabling environment and good governance, are keys to success, as well as adoption of a broader definition of privatization to include non-divestiture mechanisms such as leasing, management contracts and employee stock ownership programs. Many of the recently started programs are promising, although still at the design stage. They share commonalities related to: a formal statement of privatization; a centralized institutional framework for managing the privatization process; selection/scheduling of firms to be privatized; technical units created to value firms and guide the transactions process; a relative openness to various types of investors and a range of privatization mechanisms; and a realization that privatization cannot succeed without corresponding changes in the enabling environment. It is too early in most cases to declare the implementation of the programs a success. Many of the factors which stalled such programs in the past such as resistance from labor, lack of transparency and political opposition remain viable threats to successful implementation.

The privatization programs in Africa that have been relatively successful have failed to achieve the entire range of goals. Such countries with longer standing programs and some degree of success include Nigeria, Togo, Cote d'Ivoire, Benin, Kenya, and Ghana. Other countries' programs are at the design or early implementation stages but are promising. These include Burkina Faso, Cape Verde, Tanzania, Swaziland, Mozambique and Lesotho. While this does not represent an exhaustive list, it does serve to indicate that privatization in Africa can achieve some of its goals and an increasing number of countries are "investing" in privatization.

IV. Principles and Lessons Learned

General lessons learned regarding the critical success factors (CSFs) for privatization in Sub-Saharan Africa are already largely known. However, with the sweeping trend over the last five years in Africa towards greater reliance on market forces and democratization, the relative importance of the CSFs has changed and there is greater confidence that these are indeed the key CSFs. The challenge is to find and implement solutions. Selected lessons learned are as follows.

- *Program Design and Implementation.* Privatization programs need to be designed and implemented to efficiently and effectively meet the goals and objectives of the privatization program itself and overall economic reform. The programs need to be flexible and pragmatic and have a sound technical foundation. They must be supported by strong senior-level political commitment and an appropriate institutional framework. The key lessons learned in this area are divided into five topic areas: (i) institutional framework; (ii) portfolio composition; (iii) divestiture strategies; (iv) program operations; and (v) public relations and communications.

- *Enabling Environment.* A successful privatization program is integrally linked to establishment of an appropriate enabling environment for private sector investment, growth and competition. Key elements to success include several dimensions: macro-economic, political, regulatory and legislative. Countries need to carefully consider the sequencing of enabling environment reforms to ensure that key elements are in place prior to privatization in order to maximize investor interest and the price received for privatized enterprises. Yet, at the same time, privatization should not be delayed while waiting for too broad a range of enabling environment reforms to be put in place.

- *Governance and Transparency.* Both the privatization program itself and establishment of the enabling environment must be implemented and sustained in a highly transparent manner. In addition, the processes through which this is achieved must be based on a system of legitimate authority, public accountability and effective public management (that is, good governance).

- *Donor Assistance.* Donor assistance is often needed to encourage and support privatization programs. Donors provide policy advice, technical assistance and financial resources. Donors need to: coordinate their efforts and provide senior resources on a sustained basis; incorporate privatization as an integral component of on-going policy dialogue; recognize the uniqueness and complexity of each country situation; and carefully manage their visibility in the program so as not to undermine government authority and perceived legitimacy.

V. Targets of Opportunity for USAID Assistance

The criteria used to identify whether a particular area represents an opportunity for USAID assistance are as follows: (i) it is an important area for African privatization; (ii) USAID has past experience in the area, is seen as providing credible support, and USAID can be effective; (iii) USAID has comparative advantage in providing such support, relative to other donors and/or government; and (iv) the opportunity area supports and is consistent with USAID's overall strategy and policy.

The selected areas of opportunity identified are as follows. They all support to varying degrees USAID's strategic thrusts of building democracy and encouraging broad-based economic growth, and the strategy's underlying principles such as transparency, people empowerment, strengthening key institutions of a market economy and good governance.

- *Institutional framework* for privatization program design and implementation. Assistance is needed to: establish appropriate organizational structures with sound legal foundations; ensure that privatization units have strong technical ability and legitimate authority to implement decisions in a transparent manner; and develop "sunset" provisions for the unit.

- *Broadening share ownership (BSO).* Multiple forms of broadening share ownership are available (public offerings, financial intermediaries and trusts, ESOPs and MBCs, and voucher/mass privatization) and appropriate programs need to be designed to incorporate such features. USAID's role can be particularly effective in: developing BSO as part of capital market development; providing general "education" on the desirability of and techniques for BSO; and technical-level implementation assistance for particular BSO programs and mechanisms.

- *Compensating the "losers"* from privatization, particularly labor. Measures include: encouraging productive dialogue early on between labor groups and management/Government; supporting income-related mechanisms which address short-term dislocation, such as severance packages and ESOPs; assisting with outplacement services and retraining; and establishing entrepreneur funds and other specialized financial schemes aimed at assisting retrenched workers to start private businesses.

- *Legal aspects of governance* including the legal framework, appropriate laws and the rule of law. USAID should target: establishing rule of law through supporting constitutional amendments, building/strengthening democratic institutions and development of the judiciary; creating enabling legislation to support private sector development; and assisting with the development of privatization-specific laws and institutions.

- *Privatization of infrastructure industries*, such as telecommunications and railways, which are often thought to constitute "natural" monopolies. USAID can: promote privatization of these industries through policy dialogue; help establish the appropriate regulatory and institutional framework for privatizing these sectors; assist with pre-privatization restructuring in selected, specific areas; and develop and support programs to compensate the "losers" from the privatization of these high-employment sectors.

TABLE OF CONTENTS

TABLE OF CONTENTS *(cont.)*

1. INTRODUCTION

1.1 Background

The reform of the public enterprise (PE) sector and privatization have been key elements in structural adjustment programs in Sub-Saharan Africa since the early 1980s. Much of the early emphasis was placed on reform of public enterprises, with only minimal attention paid to actual divestiture or other forms of privatization[1]. The growing consensus that PE reform alone was insufficient to attain the primary objectives of increased efficiency of resource use and the reduction of fiscal burdens led to an increased emphasis on privatization in a growing number of countries in the mid-1980s.

The early African experience, however, with privatization was not an overwhelming success. Many observers noted the large gaps between privatization rhetoric and actions, the slow pace of implementation, and its marginal effects on efficiency and growth.[2] Programs were poorly designed, lacked transparency and sufficient political support, and often employed only a narrow range of privatization mechanisms.

Nonetheless, there are a few countries in Africa which have had some degree of success with privatization. Of course the definition of "success" is relative and integrally linked to the objectives of a given privatization program. Several of the early privatizations in Africa succeeded in stemming fiscal burdens (mainly through liquidations); a few raised revenue for Government through sales proceeds, although many argue assets were under-priced; virtually none of the privatizations totally removed economic distortions in the privatized company's sector (many PEs were sold to "insiders" and/or came with special deals/protection); and, with regards to whether overall economic efficiency and growth have been generated by privatization, it is difficult to make a determination as there is little post-privatization monitoring and the track record is not long enough (even the UK, often considered the privatization expert par excellence, has not fully addressed this fourth element).

Despite the lack of past success cases, the number of countries that have adopted formal programs of privatization has increased substantially in the last few years. The privatization phenomenon in Africa is now widespread, is central to donor relations and conditionality, and provides a core component of the political platform of many of the current governments (albeit still rhetoric in some cases). Furthermore, some of those countries that experienced limited success earlier on with privatization (eg, Cote d'Ivoire) are now beginning to implement new programs, which seem to address many of the problems of the past.

---

[1] In this report, divestiture is defined as the sale of publicly owned assets, whether shares in public enterprises, whole companies, or pieces of companies. It includes liquidation of state entities -- dissolving them legally and disposing of their assets. Privatization encompasses divestiture (the privatization of ownership), but also includes the privatization of management and other forms of privatization which do not include the transfer of assets (based on Berg's definition; July, 1993).

[2] E. Berg, July 1993.

Privatization in Africa will continue to be more challenging than in other parts of the world. However, the prospects for successful privatization appear more promising and widespread than in the past. There is also more experience with privatization in Africa and elsewhere in the world from which countries can now benefit, than was the case in the mid-1980s.

It is within this context that USAID's Office of New Initiatives in the Africa Bureau sponsored a seven-country activity in Africa with the goal of better understanding the privatization experience to date and of trying to play a small yet catalytic role in increasing the privatization momentum in each of the seven countries. Part of the premise of the activity was that privatization in Africa may have "come of age" despite assertions of many of its critics to the contrary. In addition, lessons learned to date suggested that the broader context for privatization, such as creation of an enabling environment and good governance, were keys to success, as well as adoption of a broader definition of privatization to include non-divestiture mechanisms such as leasing, management contracts and employee stock ownership programs.

1.2 Study Objectives

This report summarizes the experience gained in conducting the seven-country activity sponsored by ONI. In addition, it attempts to define lessons learned regarding privatization in Africa to date. Finally, the report identifies a number of areas, which are consistent with USAID's new policy framework, where USAID could be particularly effective in providing assistance to privatization in Africa.

Thus, the objectives of this study are to: (i) provide principles, guidelines and lessons learned regarding the design and implementation of privatization programs in Sub-Saharan Africa; and (ii) identify selected areas in which USAID could have a particular comparative advantage in providing assistance in the future.

1.3 Conduct of Study

The study is based on the International Privatization Group's (IPG) direct experience with providing privatization assistance in Africa over the last three to five years. It also draws from the specific experience gained while conducting the ONI (USAID/Africa Bureau) buy-in to the Privatization and Development (PAD) project, which involved activities in seven Sub-Saharan countries. These countries included: Senegal; Cote d'Ivoire; Cameroon; Ethiopia; Mozambique; Zambia; and Madagascar. Finally, supplementary desk research and a number of interviews were conducted in direct support of the preparation of the study.

IPG is a consortium of companies, headed by Price Waterhouse (PW), which was formed to execute the PAD project and to create a "center of excellence" for privatization research, program design and transaction assistance. Abt Associates, Inc. is a member of IPG and jointly conducted the ONI buy-in with PW.

The study was funded by the Office of New Initiatives (ONI) in the Africa Bureau of USAID, where it received technical direction from Mr. Neil Bilig. Technical support was also provided by Ms. Penny Farley (USAID/PRE), the Chief Technical Officer on the Privatization and Development project.

Mr. Anthony Davis (Abt Associates; Team Leader/Senior Privatization Specialist) and Ms. Mara Fellouris (Price Waterhouse; Senior Manager) are the principal authors of this report, and were the Technical Director and Project Manager, respectively, of the ONI buy-in. The report benefitted from review by their colleagues at Price Waterhouse and Abt Associates.

1.4 Structure of Report

The remainder of this report is structured as follows. In Chapter 2, an overview of the ONI buy-in is provided, along with a description of the activities conducted under ONI in each of the seven countries. In Chapter 3, the experience of countries which have had some degree of success to date with privatization, or have promising programs, is highlighted. In Chapter 4, general lessons learned over the last five years regarding privatization program design and implementation in Sub-Saharan Africa are presented. Finally, in Chapter 5, selected targets of opportunity where USAID might provide particularly effective support to privatization in Africa are identified and discussed.

2. ACTIVITIES UNDER THE AFRICA BUREAU ONI BUY-IN

2.1 Introduction

In October 1992, USAID's Office of New Initiatives (ONI) in the Africa Bureau commissioned an assessment of the privatization potential and related governance issues in selected African countries via a buy-in to the Privatization and Development (PAD) project. The overall scope of work, for countries selected, encompassed: (i) assessment of the status of the privatization program; (ii) review of the USAID Mission's privatization program; and (iii) analysis of the governance issues related to privatization.

The purpose of the ONI buy-in was to provide a catalytic role in advancing privatization programs and/or transactions in selected African countries and to better define country-level privatization assistance programs. As such, the ONI buy-in was not intended to form the basis of a cross-country comparative research piece, but rather to provide practical assistance to a wide range of countries.

The criteria for deciding the country in which the ONI buy-in would operate evolved over time. The following criteria emerged and were applied:

- the project activity must have the potential to have a catalytic role, within the budget available, in each country selected;
- the ONI activity could only be undertaken once in a given country, thereafter the Mission (or another entity) would have to fund continuing support for the privatization initiative assisted by ONI (with the exception of Senegal);
- the range of countries should be representative of a cross-section of Sub-Saharan Africa;
- the AID Mission in the country must request the ONI assistance; and
- the activity could be lodged at any level such as program design, Mission strategy development or transactions support, as long as the four other selection criteria were met.

Seven countries were selected, over time, as the ones to be supported by the ONI buy-in. These included: Senegal; Cote d'Ivoire; Cameroon; Ethiopia; Mozambique; Zambia; and Madagascar. The activity in each country varied in terms of scope and level of effort (see Exhibit II-1). However, the ONI activity in each country consisted, on average, of a level of effort ranging from 9 to 13 person-weeks. On some of the activities, the Mission also funded some additional level of effort. The emphasis of each country activity also was varied:

- two of the activities focused principally on assessment of the overall privatization program and the prospective role of the AID Mission (Cote d'Ivoire and Madagascar);

- three of the activities concentrated on practical training and public awareness initiatives which in turn addressed broader issues that were key to the momentum of the privatization program (Cameroon, Ethiopia and Mozambique);

- one activity provided transactions support targeted at a specific enterprise (Senegal); and

- the final activity provided lessons learned about privatization on a worldwide basis, as a key input to privatization program design in the country in question (Zambia).

The ONI buy-in was jointly conducted by Price Waterhouse (PW), the prime contractor on PAD, and Abt Associates, Inc., a subcontractor on the same project. In addition, other PAD subcontractors participated, including SRI which led the Zambia desk study and Intrados which provided input in the Cameroon activity.

Exhibit II-1

ONI Buy-ins			
Project Name	**Start Date**	**End Date**	**Budget**
Cote D'Ivoire	12/92	2/93	$ 55,757
Senegal	2/93	6/93	$ 93,723
Zambia	4/93	8/93	$ 28,106
Mozambique	6/93	12/93	$ 46,490
Ethiopia	6/93	10/93	$ 53,498
Cameroon	7/93	11/93	$ 72,259
Madagascar	11/93	1/94	$ 97,485
Senegal - Phase II	11/93	5/94	$151,426

2.2 Country Activities

For each of the seven countries in which the ONI project was active, presented below is a basic description of: (i) the status of national privatization program and the context in which the ONI activity was requested; (ii) the nature of the ONI activity itself; and (iii) the impact that the ONI activity is thought to have had.

2.2.1 Senegal

Background

Senegal's privatization program started in 1987, but began in earnest in late 1989. The program includes the privatization of 30 state-owned enterprises and the liquidation of a further 10 enterprises. Industries targeted for privatization include hotels, vehicle assembly, a cinema chain, ship repair, pharmaceuticals, animal products, real estate and construction, banking, and other manufacturing and services. When completed, revenues generated are expected to total $80 million, or around 12% of government equity in public enterprises. As of the end of 1993, 21 enterprises had been sold, seven had been liquidated, and a further six transactions were reportedly close to completion. Proceeds from sales are already near the targeted amount of $80 million[3].

The main privatization method has been public offerings, although alternative methods such as leasing, MBOs, joint ventures and employee participations have been used.[4] Factors contributing to the program's success include consultations with the private sector on determining privatization strategy and the use of case-by-case selection of privatization methods[5]. Constraints encountered include the lack of developed and sophisticated financial and banking sectors as well as competition with surrounding countries, particularly Cote d'Ivoire, for foreign capital.[6]

ONI Assistance

ONI project funds were used to assist in the privatization of SONACOS. SONACOS, the second largest industrial concern in Senegal, produces groundnut meal and oil as well as refines vegetable oil. As the principal entity of the groundnut "filiere" (industry), SONACOS and its subsidiary SONAGRAINES directly and indirectly affect at least 1,000,000 in employment.

The Government of Senegal has recently expressed again its intention to privatize SONACOS. This has been encouraged by the donor community (including the EC, World Bank, France, Germany and USAID) due to the size and importance of the company in Senegal's economy and the enterprise's need for restructuring in light of its high capacity versus low supply of groundnuts. Privatization discussions have been underway for a number of years and there now appears to be a more serious commitment to move forward.

The privatization of SONACOS will have to carefully address a number of objectives. Issues to consider include the significant social and political issues arising from SONACOS' privatization, the desire for increasing the efficiency and profitability of the sector, donor

---

[3] Drum, 1993.

[4] Cowan, 1992.

[5] Drum, 1993.

[6] Drum, 1993.

willingness to fund some part of the restructuring costs, and proper planning and management of the privatization process.

Under the ONI buy-in, a Phase I activity was completed in April 1993. It consisted of a reconnaissance mission to assist the Government in developing a framework for privatizing SONACOS. A final report describing the general conditions for privatizing SONACOS helped to build the consensus needed to ensure success.

The Phase II activity, funded jointly between the ONI buy-in and a Mission buy-in, began in November 1993 and produced a privatization strategy, recommendations for restructuring and a valuation of the company. The PAD report gave the Senegalese government the confidence to finalize its privatization agreement with respect to SONACOS with the donors under the Agriculture Sector Adjustment Program (PASA). Key PAD project members attended the PASA negotiations which were concluded in May 1993. It is expected that Phase III, implementation of the sale, will begin before year end.

The eventual restructuring and privatization of SONACOS will be a long and complex process. However, if successful it will have a significant impact on the economy. The government's continued commitment will be the single most important factor for success. The ONI activities have helped to generate momentum for the privatization process and clarified a number of significant procedural and technical issues.

2.2.2 Cote d'Ivoire

Background

Since 1977, the Government of Cote d'Ivoire has implemented a broad program of public enterprise sector reform aimed at reducing the burden of the sector on public finances and at improving the efficiency of enterprises. This culminated in the 1987-1989 period in which divestiture became a clear option for Government and about 30 enterprises were privatized.

However, until 1990 there was little evidence that the privatization program was well managed nor carried out in a transparent manner. The program was characterized by: a lack of clear procedures and guidelines for divestiture; limited transparency in the process of privatization; no specific list of PEs targeted for privatization; in many cases, Government was privatizing following direct requests from potential buyers who were offering cash; and there was a general feeling that the buyers were selected on the basis of political favoritism.

In 1990, the Government inaugurated a new privatization program based on a more transparent, impartial and formalized approach to privatization. There were no restrictions on the scope of the program, the methods of privatization, nor the origins of the target investors, sectors or enterprises. Much emphasis was placed in the early 1990s on promulgating the necessary laws and regulations to develop an appropriate institutional framework for privatization, and on communicating the program to potential investors and the general public.

In the 1991-1993 period, eight privatizations were completed involving sales of assets, direct sales, public offerings on the stock exchange, and a 3-year lease with an option to buy. Four of the eight privatizations included a sale of majority shares by Government, three of which represented a 100% holding. The program, however, was overly ambitious, anticipating the sale of 24 enterprises during 1990-92. Its slow progress was due to the overly optimistic time frame set for divestiture, an intense and continuing political debate over privatization as the main leaders "jockeyed" for position in the run up to the 1995 presidential elections, continued allegations of sales to "insiders" (foreign and domestic), and the resource-intensive effort required to set up the appropriate framework for privatization.

The pace of privatization is expected to accelerate in 1994. Preparatory work is well advanced for the telecommunications company, the national railway (joint Ivoire-Burkina service), two companies in the palm sector, three companies in the rubber sector, the gas distribution company, and two hotels.

ONI Assistance

The Mission requested that the ONI project conduct an overview and assessment of the privatization program in Cote d'Ivoire and recommend what type of assistance program, if any, the Mission should pursue.

The ONI team reviewed the overall policy, institutional, regulatory and legislative framework governing the privatization program, examined the track record with regard to transparency and other issues related to governance, and reviewed the experience with enterprises that had been recently privatized. These enterprises included: CEIB (Livestock), in which 100% of Government holdings were privatized, with assistance from CDC (Commonwealth Development Corporation), via a 3-year lease with an option to buy; CEDA and BINEA (Publications) in which 60% and 100% of Government's assets, respectively, were sold to private parties; Villages Vacances (Tourism Resorts) in which 100% of Government assets were sold to a foreign investor/operator; and CIE (Electricity) for which a concession was provided to a private company in 1990 and in turn, 24% of the electricity company was then sold through a public offering on the stock exchange in 1992.

The ONI team concluded that it was not an opportune time for the Mission to commence a major privatization assistance program, but that the Mission should revisit the issue in the next 12 to 18 months. The main reasons for this recommendation, which are inter-related, were that: (i) it was considered that the privatization program was being used as a "political football" by some of the most powerful individuals who were jockeying for position for the national elections for the Presidency; (ii) the Mission, which was largely regional in its mandate, lacked sufficient national level knowledge and resources to adequately address the complexities of the privatization program; and (iii) at the time of the assessment, it was not clear whether the privatization program since 1990 had just spent considerable time and resources on establishing the framework for privatization (in part, to satisfy donors) but would stall when it came to implementation of transactions, or whether the pace of privatization would accelerate. The Mission agreed with the team's recommendations, and has since passively monitored the program's progress.

2.2.3 Cameroon

Background

Embarking on a program of structural adjustment and macroeconomic reform under World Bank guidance in the late 1980s, Cameroon's privatization program began in earnest in October 1990 with the formal identification of 15 enterprises for privatization. Enterprises selected were largely unprofitable and highly leveraged, which increased the difficulties of the privatization task. Privatization candidates spanned a number of sectors, with agro-industry and forestry products being heavily represented. Privatization methods envisioned are flexible and there is an openness to foreign investment. Only four sales have been completed to date. They include the following.

- OCB in 1991: a large banana cultivation and marketing entity. OCB represents the Government's most successful privatization in that it was a carefully structured transaction which met the objectives of increased technology, improved access to international markets, and local participatory and capital mobilization. 51% was sold to a foreign investor, 30% was sold to local individual investors, and 20% was sold to financial institutions including the Caisse Francaise and the IFC.

- SOCAMAC in 1991: a transport company. The government sold its interests in the enterprise to a local venture capital group and still retains a portion through a maritime shipping line, which itself is majority government-owned.

- SEPBC in 1992: a wood processing/transport enterprise. The government divested a portion of its minority holdings to existing private sector shareholders and still retains a portion through another state-owned enterprise.

- COCAM in 1992: a forest exploitation and wood processing enterprise. The assets were sold to domestic investors in the forestry industry.

Most of the other enterprises on this first phase list have been put out for tender, and liquidations are underway for a number of enterprises. Key constraints to privatization have included: a complicated institutional structure which has a poor definition of roles (particularly regarding liquidations) and which gives accountability but limited decision-making authority to the privatization unit; a portfolio of unattractive enterprises which are difficult to sell even under the best of circumstances -- the Government's orientation appears to be directed towards restructuring; limited public relations efforts both at the program and transaction levels due in great part to lack of financial resources -- this has cast major doubts on the privatization process and has generated negative media feedback particularly with respect to liquidations, which themselves have been plagued by alleged fraud; a financial sector with a low level of liquidity which cannot support the credit needs of would-be investors; and general lack of investor interest, which can be attributed to the above constraints of portfolio composition, limited public relations/information, and poor credit facilities. The limited success to-date despite the enormous constraints cited above has been primarily due to the privatization unit's competent and dedicated staff.

ONI Assistance

In July 1993, the Mission requested ONI to fund technical training for the members of the Privatization Sub-Commission in Cameroon. A reconnaissance mission to identify the training requirements and familiarize the trainers with Cameroon's privatization program was conducted in August 1993. The findings from the reconnaissance mission identified the above constraints and noted that the Sub-Commission staff had in fact recently received technical training funded by the Caisse Francaise. Thus, given the nature of the program's constraints, the proposed seminar was significantly altered to include a series of workshops with the participation of the private sector. The objective of the seminar was to highlight the current constraints facing the privatization program and, through dialogue with the private sector and the Administration, to identify possible solutions.

The seminar, which took place in November 1993, was successful in terms of generating consensus on key issues and strategies. Topics covered included: selection of enterprises for privatization; alternatives for structuring transactions; financial markets and privatization financing; communications, including press and labor relations; institutional framework; and legal framework. Workshop attendance was high with a good mix of private and public sector individuals. Dialogue was open and frank. Substantial publicity was generated during the process, including interviews on television and radio, and daily press write-ups on the proceedings. Regarding the press, they were particularly enlightened as they obtained a better understanding of the balancing required to address the political, economic, social and operational aspects of the privatization process.

Whereas the impact of the assistance was high in terms of creating visibility and public support for the privatization program and essentially renewing interest, problems identified essentially remain unresolved. At the heart of the issue is the government's political will to move forward. While the government recently made a commitment to pursue privatization as part of its third structural adjustment loan, it remains uncertain whether the constraints identified will in reality be addressed. With the USAID Mission closing down, no further privatization assistance from USAID is envisioned, although the World Bank has indicated it will continue to provide assistance in this area. Thus, USAID created momentum and visibility, but unfortunately was then unable to follow-up.

2.2.4 Ethiopia

Background

The Transitional Government of Ethiopia (TGE) has undertaken a broad reform program aimed at creating the conditions necessary to make a shift from a highly centrally planned system to a market-based economy. This reform program covers a broad range of areas. Among its objectives are: limiting the role of the state in the economy; promoting private investment; and mobilizing external resources. Privatization is an important component of this program, as the TGE seeks to promote rapid development of a number of sectors, including manufacturing and industrial enterprises. Regarding industrial enterprises, the TGE's economic policy paper clearly stated that state ownership of industry would be limited to a selected number of key establishments in which government could demonstrate clear comparative advantage.

The privatization program is at the very early stages of development. While the TGE did not have a comprehensive plan of action as of mid-1993, a number of preparatory steps and initial activities had been undertaken. These included the establishment of a number of task forces, design but limited implementation of a more enabling environment for privatization and private sector investment, and the re-establishment of a number of public enterprises as autonomous entities which could function in a competitive market environment. No major sales of PEs, however, had been completed.

In this context, the Ministry of Industry (MOI) selected 50 enterprises for privatization through divestiture or other means such as management contracting, franchising or employee ownership. The MOI expressed a desire to move forward with a pilot program aimed at divesting a few enterprises as quickly as possible, and has designed severance pay programs and concessionary credit systems for potential labor displacement. A pilot group of four enterprises were selected: Addis Garment Factory; Anbessa Shoe Factory; Dil Edible Oil Factory; and Kokeb Flour and Pasta Mill. All four enterprises are small, relatively autonomous in their operations, control small market shares, and have largely domestic procurement needs and sales. Other sectors where enterprises are expected to be divested include hotels, farm units, retail shops and restaurants.

ONI Assistance

ONI was asked to provide the Ethiopian Ministry of Industry with the services of a short-term technical specialist to train selected MOI-designated individuals in financial analysis and valuation techniques, and to assist MOI in carrying out valuations of the four pilot group enterprises slated for privatization.

The training course was attended by about 14 participants, and was conducted three days per week over a nine-week period. The training covered basic financial analysis concepts and techniques, and provided an overview of the more important valuation methodologies. Following the period of classroom training, the participants were divided into teams and assigned to carry out valuations of one of the four enterprises. In addition, at the end of the training course, the MOI and USAID/Ethiopia hosted a half-day seminar to present the results of the training program and the MOI's broader privatization efforts, as well as to stimulate discussion of the country's overall privatization program.

The valuations of the four enterprises were still on-going at the end of the assignment. However, while precise details were still being finalized, it was generally agreed that: the Addis Garment Factory and Anbessa Shoe Factory were saleable as going concerns; the Dil Edible Oil Factory was not saleable as a going concern, but had considerable liquidation value; and the Kokeb Flour and Pasta Factory should be split into two entities, with the Flour Mill sold as a going concern and the Pasta Factory liquidated.

At the conclusion of the assignment, the ONI team also provided some suggestions to the Mission as to how it might best support TGE's privatization initiatives in the future. These mainly related to the institutional framework, and processes and procedures for carrying out the privatization program.

At the end of the training program, the MOI participants were capable of carrying out basic valuations themselves. In addition, the program was successful in its goal of assisting the MOI to value the enterprises in the pilot group, and played a catalytic role in encouraging MOI (and the Government in general) to move forward with privatization.

2.2.5 Mozambique

Background

The origins of Mozambique's privatization program stem from the 1987 Economic Rehabilitation Program, which was a comprehensive structural adjustment program aimed at shifting Mozambique from a centralized to a market-based economy. Parastatal reform and privatization was an integral component of the overall program.

The early efforts related to privatization included the promulgation of some enabling legislation, establishment of an institutional framework (embedded in sectoral Ministries), and the sale of about 240 state-owned enterprises. These SOEs were mainly small to medium sized companies. About 70% were sold outright, 10% were privatized via joint ventures, and the remaining 20% were transferred through leasing contracts.

Since 1991, the Government of Mozambique has concentrated its efforts on establishing a more formalized legal and institutional framework for privatization, and undertaking preparatory work for the restructuring and/or privatization of larger SOEs. Progress with actual transactions for the larger companies has been slow, which is to be expected given the national focus on negotiating a peace settlement to a 17-year civil war. However, since the peace settlement, the pace of privatization has accelerated. Between late 1992 and early 1994, six larger sized companies were sold (Sulpesca; Marbeira; Gambeira; Textil de Mocuba; Fab. de Ref. da Machava, and Fab. de Ref. da Beira), with a total direct investment value of $115 million, of which 50% was foreign sourced. Another five are in the final negotiation phase. Even for some companies which are at earlier stages of preparation (eg, pre-qualification of investors scheduled in the future), expressions of interest have been received (eg, COGROPA/Food Sector and TTA/Aviation).

The future of privatization, depending on the sustainability of peace after the national elections, is moderately promising. The institutional framework is in place, transparency has been relatively high, the new investment law of June 1993 is quite liberal, and the privatization-related laws are progressive and permit a wide range of sales methods. Presently, 33 companies are in the "pipeline" for privatization and are being prepared for sale either by UTRE (Technical Unit for Enterprise Restructuring) or the relevant line Ministry, and another 20 companies are being considered for placement on the sales list.

ONI Assistance

Assistance was requested from ONI to provide continuing support for the liberalization of the trucking industry and privatization of the four main parastatal trucking companies. These companies included: CAMOC, the state-owned national trucking company; AGRICOM's fleet, the main agricultural marketing and distribution parastatal; DPCCN's fleet, the national relief and emergency agency; and Transcarga, a major government-owned truck operator on the Beira Corridor.

USAID and the World Bank had been assisting with the technical design of the sector's liberalization and privatization program. However, the donors felt that a critical step in building momentum for the implementation of the program was to raise key issues and develop consensus among major stake holders in the trucking sector via an interactive workshop/seminar. ONI was asked to plan the workshop and prepare key materials. These included papers on industry regulation, trucking company privatization and the enabling environment for the trucking sector, as well as support in the development of the seminar's agenda and participant list.

The seminar itself was postponed on a number of occasions, in order that the post-peace settlement situation might be better reflected in the seminar's proceedings. However, before the seminar could be held, the World Bank insisted on Government preparing, on a tight schedule, an action plan for the trucking sector, as a condition for the approval of a major roads and coastal shipping sector project. While Government heavily utilized the papers prepared for the seminar in order to draft its action plan submission to the Bank, the seminar itself was never held. As a consequence, and due to other factors as well, the privatization program for the trucking sector has stalled and many of the assets of the candidate enterprises have deteriorated or disappeared in the interim.

2.2.6 Zambia

Background

The Zambia privatization program began formally in 1992 with the approval of the Privatization Act establishing the Zambia Privatization Agency (ZPA). As a component of Zambia's structural adjustment and macro-economic reform program, the privatization program encompasses about 150 enterprises, in 11 tranches, which are to be privatized over the next few years. These in total represent a contribution to the nation's GDP of approximately 85%.

To complete the privatization program, the ZPA is relying heavily on donor assistance which has been provided by USAID, ODA, GTZ, NORAD, UNDP and the World Bank. USAID is the most significant donor in the process. In addition to providing a number of advisors to the ZPA during 1991-1992, USAID embarked upon a major technical assistance project in early 1994. This multi-million dollar project will provide substantial long- and short-term assistance to the ZPA in all stages of the privatization process. Assistance will also be directed towards developing capital markets including the establishment of a stock exchange.

Zambia's privatization program has experienced some progress, although certain constraints have prevented the final completion of some transactions. A key element of its "tranche" strategy has been to divest the "easier" enterprises first, in order to gain experience and build momentum through demonstrated successes. Foreign investment, including South African, is welcome. As of October 1993, the status of the 19 "Tranche 1" companies was as follows:

Ownership Transferred:	2
Ownership Transfer in Progress:	9
SOEs being Rebid:	5
Final Recommendations to ZPA Board:	2
Liquidation Underway:	1

Key constraints to the program have included the institutional structure, the enabling environment, and the privatization process itself. The institutional structure has presented significant constraints with respect to cooperation, accountability and full availability of resources. Whereas sales have been "completed", the new investor(s) do not actually have possession of the enterprises. Other constraints include: lack of available financing for domestic investors; unclear title to property; confusion on the part of potential investors on specific privatization processes and "rules of the game"; valuation techniques and interpretation; difficulties in maintaining confidential information from the press; and resistance from SOE employee and management, resulting in large part from poor information dissemination.

ONI Assistance

To support the Mission and the Zambia Privatization Agency in its privatization efforts, ONI was requested to fund a "desk study" on lessons learned in privatization worldwide. Specific examples of countries' experiences which could be adapted by Zambia were to be emphasized. The rationale for the ONI assistance was a perception in Zambia that lessons learned elsewhere in the world needed to be understood in order to design a better, formal program of privatization in Zambia.

Selected themes to be analyzed in the study were agreed upon with the Mission and ONI. These included the following.

- Enterprise Classification Systems
- Privatization Methods
- Valuation and Guidelines for Asset Disposal
- Financial Markets and Alternative Financing Instruments
- Policy and Regulatory Reforms
- Techniques for Encouraging Local Ownership
- Overcoming Political and Social Obstacles to Privatization
- Environmental Issues Affecting Privatization
- Labor Retrenchment and Social Safety Nets
- Investment Regulations and Privatization
- Investor Searches

Drawing on worldwide experiences in each of these topic areas, the report presented implications and recommendations for the Zambia privatization program. The report has been a valuable "primer" for the Zambian privatization program and others. The report has been distributed widely. It has proved to be very cost effective and a high impact form of privatization assistance.

2.2.7 Madagascar

Background

Starting in 1988, with the assistance of the World Bank and the IMF, the Government of Madagascar (GRM) agreed to formulate a three-year program to rehabilitate its public enterprise sector. The program was meant to cut the size of the PE sector to about half its initial size through liquidation, divestiture, restructuring and privatization. At the same time, a moratorium was imposed on the creation of new PEs and limitations were imposed on the level of bank credit and budgetary transfers to existing PEs.

In 1990, a team was put together to review the status of the PEs and to develop a master plan for privatization. This was an ambitious plan, covering the sale or liquidation of more than half of the Government's PE portfolio and aiming principally at divestiture of non-performing enterprises. Until the program was suspended in mid-1993, more than 80 companies had been liquidated or privatized, while at the time the program was suspended a further 38 were slated to be sold before the end of 1993.

Although the privatization program managed substantially to reduce the number of companies under state ownership, a great many of these were enterprises in name only, many of which had not operated in ten years or more, and whose assets, if they could still be identified, were of limited or no value. This was especially true of many companies created in rural areas for which the economic justification, if any, had been slight from the outset.

As of late 1993, although the GRM had not renounced the concept of privatization, it had not indicated whether or when it would revive the program. Indeed, the disbursement of the third tranche of $45 million of the World Bank's structural adjustment credit, which was conditional on progress in privatization, had been blocked. A number of concerns were cited by Government as reasons for suspension of the privatization program: (i) assets and shares were generally thought to have been sold below their "real" value; (ii) the ownership of some of the component assets of PEs being sold was ambiguous; (iii) the whole process lacked transparency; and (iv) no mechanisms were used to promote broad-based Malagasy ownership.

The new government of Fransicque Ravony recently announced that it is in the process of reviewing the general principles and the modalities of its privatization program. The GRM is also contemplating on what kind of a structure it plans to employ for best results. However, these are not the only concerns of the Ravony government. Besides finding the right structure and the modalities of more acceptable privatization program, the new government encounters a strong nationalistic sentiment vis-a-vis privatization. The Malagasy seem very much concerned about losing their "national patrimony" to "foreigners" and to their "ex-colonizers." There is also growing skepticism about the benefits of privatization.

Despite all these concerns, some acceptance of the need to privatize exists, reinforced by considerable pressure from the World Bank and other donors. Government continues to state its intention to pursue privatization -- the Minister of Economy going so far as to state recently that privatization, along with liberalization and decentralization, was one of the principal elements of the Government's economic policy. It is uncertain, however, whether the GRM has a clear sense of how to restart the privatization program in such a way that the mistakes of the past can be avoided.

ONI Assistance

ONI assistance was initially sought to provide an overall review and assessment of the privatization program in Madagascar and to recommend what form of assistance the USAID Mission might provide (similar to the Scope of Work under the Cote d'Ivoire activity). However, it soon became apparent that the Government's suspension of the privatization program and the lack of progress with creating an enabling environment for private sector development, meant that the ONI team should not focus exclusively on privatization and instead broaden their scope of analysis.

Consequently, the ONI team assisted with the design of a project, entitled Business Enterprise Services and Technology (BEST), which is intended to address perceived legal and regulatory constraints to private sector development and to improve the quality, availability and delivery of business services to the private sector. The analysis, thus, included a detailed review of public enterprises and privatization, the legal system, and other elements of the enabling environment. The assistance resulted in the preparation of a report which formed the basis of the Mission's Project Identification Document (PID).

The BEST project has subsequently been designed and the Request for Proposals are expected to be circulated during 1994.

3. SUCCESSFUL PRIVATIZATION PROGRAMS IN AFRICA

3.1 Introduction

The reform of the public enterprise (PE) sector and privatization have been key elements in structural adjustment programs in Sub-Saharan Africa since the early 1980s. Much of the early emphasis was placed on reform of public enterprises, with only minimal attention paid to actual divestiture or other forms of privatization. The growing consensus that PE reform alone was insufficient to attain the primary objectives of increased efficiency of resource use and the reduction of fiscal burdens led to an increased emphasis on privatization in a growing number of countries in the mid-1980s.

The early African experience, however, with privatization was not an overwhelming success. Many observers noted the large gaps between privatization rhetoric and actions, the slow pace of implementation, and its marginal effects on efficiency and growth. Programs were poorly designed, lacked transparency and sufficient political support, and often employed only a narrow range of privatization mechanisms.

Nonetheless, there are a few countries in Africa which have had some degree of success with privatization. Of course the definition of "success" is relative and integrally linked to the objectives of a given privatization program. Several of the early privatizations in Africa succeeded in stemming fiscal burdens (mainly through liquidations); a few raised revenue for Government through sales proceeds, although many argue assets were under-priced; virtually none of the privatizations totally removed economic distortions in the privatized company's sector (many PEs were sold to "insiders" and/or came with special deals/protection); and, with regards to whether overall economic efficiency and growth have been generated by privatization, it is difficult to make a determination as there is little post-privatization monitoring and the track record is not long enough.

Despite the only degree of success cases in the past, the number of countries that have adopted formal programs of privatization has increased substantially in the last few years. The privatization phenomenon in Africa is now widespread, is central to donor relations and conditionality, and provides a core component of the political platform of many of the current governments (albeit still rhetoric in some cases). Furthermore, some of those countries that experienced limited success earlier on with privatization (for example, Cote d'Ivoire) are now beginning to implement new programs, which seem to address many of the problems of the past.

As the level of effort of this ONI-related activity was limited, this report does not attempt to give a comprehensive assessment of either individual African countries' privatization programs nor summaries of all African countries currently embarking upon privatization. In addition, it must be noted that factual information on privatization in Africa, particularly concerning transactions, is sparse and widely recognized to be of uneven quality.

Development practitioners focusing on privatization in Africa frequently comment on the lack of available information on specific privatization initiatives in African countries. Comprehensive post-privatization analyses are rarely undertaken by either donors or host countries. From the "grand public" perspective, such lack of information unfortunately often leads to the incorrect conclusion that privatization is not being applied successfully in Africa. From an individual country perspective, it is unfortunate to see what little information is available to countries to assist them in the process and prevent them from "reinventing the wheel". While there is no "cookie cutter" approach to privatization, there is no doubt that increased information dissemination about specific approaches used in various countries would assist African privatization programs.

Despite the above limitations, it is apparent that privatization can and has been successful in Africa. Depending upon the definition of success, many privatization programs are achieving their countries' objectives of increasing private sector participation in the economy while removing government's involvement, both through privatization and through creating an enabling environment which encourages private sector growth. Privatization in Africa cannot be measured solely by the number of executed deals and revenue raised. Privatization in Africa is a complex issue and entails a long and difficult process. Environmental factors in Africa, when taken in unison, present unique challenges for those charged with designing and implementing privatization programs.

3.2 Successful Privatization Programs in Africa

The empirical base of long-standing programs which were successful is not extensive. However, in recent years, many more countries in Africa have been developing privatization programs. Many of the recently started programs are promising, although still at the design stage. They share commonalities related to: a formal statement of privatization; a centralized institutional framework for managing the privatization process; selection/scheduling of firms to be privatized; technical units created to value firms and guide the transactions process; a relative openness to various types of investors and a range of privatization mechanisms; and a realization that privatization cannot succeed without corresponding changes in the enabling environment. It is too early in most cases to declare the implementation of the programs a success. Many of the factors which stalled such programs in the past such as resistance from labor, lack of transparency and political opposition remain viable threats to successful implementation.

The definition of what constitutes a successful privatization program must be specified in order to review the "track record". Success is dependent on what the goals of the program are and whether they have been achieved. Most privatization programs have as primary goals increased economic efficiency and growth, resulting from the transfer of ownership or management control of public enterprises to the private sector. Secondary goals relate to stopping the fiscal drain that many PEs pose on the public ledger and raising revenue for Government.

The early privatization programs in Africa had some degree of success in achieving some of the more immediate secondary goals, but few achieved the primary economic goals.

- Cease Fiscal Drain. Several of the early privatizations did stop the fiscal drain that PEs represent to public sector finances. Many PEs were liquidated, and direct subsidies were eliminated. However, many of the firms liquidated had ceased operations long ago and had not received subsidies for several years. Thus, the liquidation merely represented striking the firm's name off the list of PEs and formally declaring that it ceased to exist, but with no change in financial flows.

- Raise Revenue. Another secondary goal of privatization can be to raise revenue for Government through the proceeds of selling the PE or through fees obtained via such mechanisms as leasing or management contracts. Many privatizations in Africa have achieved this goal as well. However, there is usually a constant debate as to whether PEs were sold for the "right" or "real" price, or whether Government was selling the "family jewels" at "bargain basement" prices. It is very difficult to determine what the "right" price is for PEs both conceptually and in practice, due to varying methodologies[7], market imperfections and the ultimately political nature of privatization itself. However, there is general consensus that Governments in Africa have not been even close to maximizing sales revenue.

- Eliminate Economic Distortions. In addition to receiving direct subsidies, many PEs benefit from indirect subsidies and distortions such as preferential access to markets, statutory monopolies, price guarantees, and so forth. A goal of privatization is to remove such distortions by transferring the PE to the private sector, and thereby increase economic allocative efficiency. There has only been varying success in achieving this goal in Africa. Many transactions to date are thought to have gone to "insiders" who not only have "bought" the PEs at a discount but have managed to negotiate a continuance of many of the distortions that the PE benefitted from in the past. The lack of transparency that often characterizes privatization programs, especially at the transaction stage, makes it difficult to prove or negate such assertions.

- Stimulate Economic Growth. The ultimate goal of privatization should be to stimulate economic growth, largely through improved allocation of resources. There is little evidence on this issue in Africa. There is little indication that growth has been correlated with privatization -- particularly as: (a) little growth has been recorded in Africa in the last decade; and (b) there are a myriad of factors which explain growth, only one of which might be privatization. However, general reliance on market forces rather than state control of production does seem correlated with growth, and thus to the extent that privatization is a key component of market reforms, then the relationship does exist. In addition, growth is a longer term objective, and the track record in Africa is not sufficiently long to test the relationship with privatization. Finally, the monitoring of post-privatization performance of enterprises is scarcely done in Africa, and where it is, the data tend to be related more to whether the company remained in business or was profitable rather than whether it had a positive economic impact. Even in the UK, a country with one of the more longstanding and sophisticated privatization

---

[7] "Selling Public Enterprises: A Cost-Benefit Approach", L. Jones, P. Tandon and I. Vogelsang, MIT Press, 1990.

programs, consensus has not been reached as to whether privatization fully achieves the economic goals that its proponents claim.

There are other goals of privatization such as the broadening of share ownership, mobilization of domestic resources, supporting the development of a formal financial sector, selling PEs to specific domestic groups, and so on. Some of these goals are clearly more politically motivated than economic, and have been met to varying degrees in different African countries.

Keeping this relative hierarchy of goals in mind, it can be said that a number of privatization programs in Africa have been relatively successful, although none have achieved the entire range of goals. Such countries with longer standing programs include Nigeria, Togo, Cote d'Ivoire, Benin, Kenya, and Ghana. Other countries' programs are at the design or early implementation stages but are promising. These include Burkina Faso, Cape Verde, Tanzania, Swaziland, Mozambique and Lesotho. While this does not represent an exhaustive list, it does serve to indicate that privatization in Africa can achieve some of its goals and an increasing number of countries are "investing" in privatization.

Presented below are selected details on a few African privatization programs which are relatively successful, or are promising. All of them, however, will need to carefully manage their program's implementation in order to increase the chances of continued success. The inherent forces which lead to the stalling or break-down of a privatization program are ever-present in Africa.

3.2.1 Nigeria

Nigeria's privatization program began in mid-1988 and although its goal to complete the process by late 1992 has not been realized, significant progress has been made. Within a framework of democratization and macro-economic reform, initial divestiture plans placed a significant emphasis on public offerings, with private placements and liquidations identified for selected enterprises. The Nigerian privatization program extends to almost every industry, except defense.

Approximately 78 out of the 92 enterprises cited in the privatization decree were wholly or partially privatized in the first three years of the government's privatization program. These generated significant revenues for the government and a growth in Nigerian capital markets from N8 billion to over N22 billion in 3 years[8]. Over 400,000 new shareholders have been created in the process. Significant transactions have included sale by the government of 100% of the Lagos Federal Palace Hotel to Ikeja Hotels, a local concern, for $50 million. Nigeria's Bureau of Public Enterprises is in the process of selling over 200 million shares in eight banks: Afribank Nigeria, Allied Bank of Nigeria, First Bank of Nigeria, FSB International Bank, International Merchant Bank of Nigeria, NAL Merchant Bank, Savannah Bank of Nigeria and Union Bank of Nigeria. Shares have been allocated proportionally amongst the federations' 30 states and the federal capital.

---

[8] Cowan, 1992.

Key factors to the program's success have been targeted use of its nascent capital markets which has enabled it to achieve its objective of wide-spread ownership, its high degree of transparency supported by a strong information dissemination campaign, the capabilities of the privatization staff who have been seconded from the private sector, and extensive use of outside expertise.[9]

3.2.2 Benin

With significant assistance from the World Bank, Benin's privatization program is one of the earliest ones begun in Africa. Accompanied by macroeconomic reforms, Benin's privatization program began in 1984 and has seen the privatization or liquidation of 100 out of 120 government-owned enterprises. A majority of the transactions involved foreign, mainly French, investors due to the need for investment capital and technical/management expertise -- which were both lacking domestically.

Significant deals included Benin's national beer enterprise, Le Beninoise, which was bought by a French concern and small domestic transporters, and the national cement company, which was sold to a Norwegian company active in West Africa (including Nigeria and Togo). Its "international" hotel underwent privatization of management through a management contract. The larger transactions included negotiations with buyers with respect to maintaining employment levels for a certain period based upon production levels. A social safety net program including retraining of laid-off employees was also implemented.
Keys to the program's success have been the government's resolve to move forward, a strong capacity within the privatization unit, an effective use of outside expertise, an openness to foreign investment and a case-by-case, flexible approach to each transaction. Challenges now facing the program include the divestiture and/or restructuring of the remaining SOEs. Many are considered "strategic" such as telecommunications and electricity, and require complex regulatory reform. Progress is also inhibited by the institutional framework for privatization.

3.2.3 Burkina Faso

Burkina Faso's privatization program is also a component of a broader macroeconomic reform program designed to promote private sector activity and improve public sector management.[10] Started in 1991, principal program strategies have been to start with profitable, relatively small enterprises in order to have early "success stories" to give the program momentum. A total of 21 SOEs have been initially slated for privatization with the first tranche (12 SOEs) to have been completed by the end of 1993.

Privatization targets have been surpassed as fourteen transactions have been completed as of the end of 1993. Primarily sold to local investors, enterprises have included an insurance company, a beer producer, a scooter manufacturer, a publicity agency (with a foreign partner), two agribusiness enterprises, one veterinarian products manufacturer (sold to local doctors with additional participation of doctors in Senegal and Benin), and a pharmaceutical manufacturer

[9] Drum, 1993.

[10] Financial News, 1993.

with existing minority French interest (sold to a group of pharmacists). Two enterprises involved in the collection and processing of hides, respectively, were sold as one package to a local woman entrepreneur already involved in the leather industry. The largest transaction, which generated US$ 5 million in sales proceeds, was the sale of the national cement company to Holderbank. Another large transaction, privatization of the joint Burkina-Cote d'Ivoire railroad through a concession and lease agreement, is thought to be close to completion.

Key factors contributing to the program's success so far, in addition to beginning with "easier" enterprises, have been a competent and dedicated privatization unit, the active targeting of local investors, and the willingness of the government to grant lenient payment terms (50% up front, with the rest paid within three years). Constraints to date have included lack of assistance from the state-owned banks, which themselves have large portfolios of non-performing loans and share holdings in unprofitable SOEs, and the lengthy period to close deals resulting from institutional composition of the privatization commission, which includes only government individuals who work part-time on the program. An additional constraint has been the lack of public information on the program as well as limited access to information and lessons learned by other African countries. The former is being addressed with the recent launching of a major public information campaign to explain the benefits of privatization to Burkina's citizens[11]. Constraints will become more serious as the government embarks on larger, more complex privatizations where new strategies including the active targeting of foreign partners will have to be developed.

3.2.4 Cape Verde

With significant funding from the World Bank, Cape Verde's privatization program began in 1992 and commenced with a preliminary assessment of potential privatization candidates among its public enterprise sector. Cape Verde's privatization program must be viewed within the context of its relatively small population of 380,000 covering ten islands. As a component of the country's macroeconomic reform program designed to improve industry efficiency and increase private sector activity, the privatization program envisages the initial sale of assets or shares in about 20 companies in a broad range of sectors including air transport, telecommunications, hotels, insurance, agro-industry, textiles, pharmaceuticals, fishing, and tourism. Social safety nets are a critical consideration and have been addressed in both policy form and financially through assistance from the World Bank.

Five liquidations have been completed to date. The liquidation of FAP (animal husbandry) resulted in the creation of four private enterprises, the new owners of which were introduced to institutions which provide management training and related assistance to entrepreneurs. Similarly, the liquidation of ONAVE (comprehensive boat repair services) resulted in two private sector enterprises producing fiberglass materials and a smeltery company, respectively. One warehouse, a subsidiary of ARCA VERDE shipping SOE, is currently under lease to the private sector and its sale to the lessees is under consideration.

[11] PR Newswire, 1994.

The government is approaching the implementation of the privatization program methodically and cautiously, soliciting outside expertise for the majority of the valuations. Although a number of valuation and appraisal studies have been completed to date, progress on sales of going concerns has been limited.

3.2.5 Tanzania

Tanzania's privatization program, which began in 1993, envisages the privatization of 350 to 400 state-owned enterprises in a four-year period. With significant support from the World Bank, privatization initiatives are being accompanied by macroeconomic and financial sector reforms with long-range plans including the development of capital markets and perhaps the creation of a stock exchange. Many of the enterprises slated for divestiture are no longer operating and will be liquidated. Other privatization strategies include share sales, leasing, management contracts and other methods which would allow indigenous Tanzanians to acquire shares sold. With World Bank assistance, a social safety net project for labor retrenchment is also being planned.

Approximately sixteen transactions have been completed as of March 1994. Progress to date has included the privatization of almost all of the state-owned leather industry -- three enterprises were sold to one foreign investor and the fourth to a second investor to avoid creating a private monopoly. Additional sales included the partial sale of a brewery to South African firm and the sale of the Wazo Hill Cement Factory to Norwegian and Swedish investors with 5% of the equity sold to the employees[12]. Industries currently under privatization include pulp, paper and sawmill; pharmaceuticals; and engineering services.

Whereas the program is still in its formative stages, successes can be attributed to the flexibility of the program, a transparent approach which has encouraged public debate and served to generate consensus among political leaders, openness to foreign investment, and a privatization unit whose staff is motivated and well compensated (in U.S. dollars).

Constraints encountered to date include lack of in-house privatization knowledge, fear of concentrated ownership particularly if among the Asian community, and poor infrastructure which is not conducive to attracting foreign investment. In addition, it was revealed that the World Bank had been putting pressure on the government to close a specific number of deals, which in turn negatively affected the government's negotiating position in the sales process.

[12] Agence France Press, 1994.

4. GENERAL LESSONS LEARNED

4.1 Introduction

In this chapter, general lessons learned regarding the critical success factors for privatization in Sub-Saharan Africa are presented. The analysis is based upon a review of recent literature, interviews with selected experts, IPG's experience on the ONI-funded activities in the seven countries, and IPG's general experience with privatization in Africa in recent years.

Many of the critical success factors (CSFs) are already largely known. However, with the sweeping trend over the last five years in Africa towards greater reliance on market forces and democratization, the relative importance of the CSFs has changed. In addition, there is greater confidence that these are indeed the key CSFs -- the challenge is to find and implement solutions.

4.2 Privatization Program Design and Implementation

Privatization programs need to be designed and implemented to efficiently and effectively meet the goals and objectives of the privatization program itself and overall economic reform. The programs need to be flexible and pragmatic and have a sound technical foundation. They must be supported by strong senior-level political commitment and an appropriate institutional framework.

The key lessons learned in this area are divided into five topic areas: (i) institutional framework; (ii) portfolio composition; (iii) divestiture strategies; (iv) program operations; and (v) public relations and communications.

4.2.1 Institutional Framework

- The institution(s) charged with implementing the privatization program must have the ability and authority to implement decisions, and the clear right to sell a given public enterprise.

- The best organizational arrangements for implementing a divestiture program tend to include: (i) setting up a high-level committee to guide and monitor the program; and (ii) creating a single entity with responsibility for managing (technically and day-to-day) the program.

- Decision-making authority within the privatization unit should be vested in the hands of more than one official. This mitigates potential accusations of personal bias, and is more expedient for the program because there is more than one individual who can make decisions (avoids potential bottlenecks).

- Provisions need to be made to ensure that the privatization unit has a clear charter to evolve into another function once the privatization program is well-advanced. The important skills generated during the conduct of the privatization program could be used for such functions as SOE performance monitoring and portfolio management, or business advisory services (the unit could be "privatized" in order to deliver the business advisory services). Such "sunset" and "evolution" provisions should: (i) ensure that the unit does not slow down the privatization process because the staff are concerned they are "working themselves out of a job"; and (ii) leverage the skills generated.

4.2.2 Portfolio Composition

- It is important to have early success cases in the privatization program to build credibility and momentum. However, the program should not focus first on small, non-viable enterprises which do not represent a budgetary drain on Government.

- Enterprise selection and classification are essential components of the program. There should be a diverse portfolio and flexibility with regards to divestment mode.

- A case-by-case approach to larger, more complex firms and/or those operating in non-competitive industries/markets (telecommunication, railways, utilities, plantations, agricultural marketing parastatals, etc) should be followed. Significant levels of technical assistance are usually required.

4.2.3 Divestiture Strategies

- Greater use of mechanisms which do not transfer ownership, or only partial transfer ownership, need to be used. Key methods include leasing (with or without an option to buy), management contracts, contracting out, debt/equity swaps, and sale of component (or, non-core) businesses.

- A greater use should be made of phased payments, such that the buyer of an enterprise pays part of the sale price out over time. This reduces up-front capital requirements and allows the investor to earn income from operations to offset payments. This especially applies to domestic purchasers.

- It is better to let the buyer do the restructuring and adjust the selling price accordingly. However, it is often necessary to clean up liabilities and assure buyers that no residual financial claims exist. Some advance legal restructuring will be necessary in selected cases, as well.

- Special privileges (monopoly rights, import concessions, etc) should not be used as "sweeteners" to sell uneconomic enterprises.

- Misconceptions about the importance yet limitations of the valuation process often stalls privatization. Strong technical expertise to conduct valuations in a transparent manner will serve to mitigate this risk.

- Criteria for approval of divestiture decisions should include economic (Cost-Benefit Analysis) as well as financial considerations.

- Liquidations are an integral part of privatization and management of the PE portfolio. Explicit efforts must be made to engender greater acceptance of a proactive liquidation program, especially of enterprises which represent a financial drain on Government and have little to no chance of becoming commercially viable.

- "Corporatization" or commercialization are often necessary preconditions for privatization, but do not represent privatization itself. Clear steps need to be established early on to proceed from these interim stages through to privatization.

- Management buy-outs (MBOs) can be a successful method of privatization, assuming the requisite management skills are available in the enterprise. However, there is often a need for advisory assistance to the management team to facilitate the preparation and implementation of the transaction.

- Mechanisms need to be implemented which address the needs of the small investor so everyone feels they have a chance to benefit from privatization.

- Broadening share ownership (BSO) is increasingly an important element of privatization -- to mobilize additional financial resources and/or build "ownership" for the privatization. BSO can be accomplished through public offerings where the appropriate financial infrastructure is in place, or where such infrastructure is lacking, through such methods as ESOPs, voucher and auction systems.

4.2.4 Program Operations

- Privatization critical paths require transparency, flexibility, pragmatism and a strong technical foundation. The path includes: audit; valuation/pricing; documentation; communications; structuring transactions; and negotiation.

- The timetable set for privatizations needs to be realistic, taking into account not only the institutional and human resources capacity of the privatization agency, but also the absorptive capacity of the market.

- Appropriate skill sets are needed to implement an efficient, effective and transparent privatization program. This can be achieved through an appropriate composition of the Privatization Unit, training and/or use of technical assistance and resident advisors.

- Sufficient resources must be made available to fund the privatization program. Budgets should cover day-to-day operations, including paying staff competitive private sector salaries, funding programs for targeting and marketing to investors, and implementing strong public relations campaigns.

- Privatization funds in which part or all of the financial proceeds from sales are deposited to fund such elements as enterprise financial restructuring and the operations of privatization unit can be useful sources of financing if the fund is well managed. Financial support by donors is typically required in the early part of the privatization program, until sale proceeds become available.

- Successful privatization implies involvement and support from enterprise management and employees. Local management and other stakeholders should be included in the privatization process to build "ownership" and to pre-empt a potential impediment.

- Establishment of social safety nets and means to compensate the "losers" are key to successful privatization. The target recipient group should be made aware early on of the existence and composition of the safety net/compensation package.

- Post-privatization monitoring of enterprise performance can be a useful means for checking if the financial and economic goals of the privatization have been met, and to generate continued momentum for the program.

4.2.5 Public Relations and Communications

- Acceptance of privatization by organized labor and other stakeholders is critical. Communications and PR campaigns are needed in order to generate such acceptance. Such campaigns should occur early on and throughout the program, and be conducted in a highly objective manner.

- Public perception of the privatization program is critical to success, even if members of the public are not potential investors in privatized firms. PR and communications programs are needed to promote awareness, understanding and transparency.

- Effective PR and communications programs are needed to facilitate the success of certain methods of finding buyers and raising finance, such as investors searches and public offerings.

4.3 Enabling Environment

A successful privatization program is integrally linked to establishment of an appropriate enabling environment for private sector investment, growth and competition. Key elements to success include several dimensions: macro-economic, political, regulatory and legislative.

- Linking privatization to macro-economic performance is key. Privatization should be seen as only one key element in a structured program of macro-economic reform. Privatization is neither an end in itself, nor a reform which can be taken in isolation of others. There is a strong correlation between successful privatization, macro-economic reform and income levels.

- Political will, acceptance and the sustainability thereof for privatization is of paramount importance. A senior-level champion helps to ensure such commitment.

- Developed financial sectors and capital markets greatly facilitate privatization. The privatization authorities should "champion" the requisite reforms which support privatization specifically and the development of the economy more generally.

- An appropriate, well-functioning legal framework needs to be in place for privatization to succeed: property law, bankruptcy law, corporate/contract law, anti-trust law, etc.

- Investor-friendly policies are needed: no restrictions on foreign investment/entry, equal treatment of foreign, local and ethnic investors, currency convertibility, etc.

- The sequencing of enhancing the enabling environment must be carefully coordinated with implementation of the privatization program.

4.4 Governance and Transparency

Both the privatization program itself and establishment of the enabling environment must be implemented and maintained in a highly transparent manner. In addition, the processes through which this is achieved must be based on a system of legitimate authority, public accountability and effective public management (ie, good governance). Some key elements include the following.

- The rule of law and legitimate authority needs to be established such that the public and corporations have confidence that laws will be upheld in an impartial, consistent and transparent manner.

- Transparency in the conduct of the privatization program and clearly established "rules of the game" must be in place. All parties must perceive impartiality and openness at every stage of the process.

- Governments need to explicitly state and disseminate the privatization program objectives and policies -- to the public as well as prospective corporate investors (domestic and foreign).

- The processes and procedures through which privatization transactions are implemented must be transparent and have built-in "checks and balances". This can be especially critical in the case of liquidation or Chapter 11 type restructuring where an administrator/liquidator is appointed, and often left unsupervised by a Board and/or the Privatization Unit.

4.5 Role of Donors

Donor assistance is often needed to encourage and support privatization programs. Donors provide policy advice, technical assistance and financial resources. Critical success factors for donor assistance include the following.

- Donors need to coordinate their efforts in a given country to support privatization. This includes internal consistency in their own country program strategies, and with other donors.

- The donor must be prepared to devote a substantial portion of program resources and management time to privatization to be effective -- and sustain the requisite level of support over potentially very long periods of time.

- The donor must include privatization as an integral part of on-going policy dialogue on reform and private sector encouragement.

- The donor needs to have a senior-level person assigned to assisting the privatization program, because of the technical complexities of privatization and the political/process subtleties which occur at the highest level of Government visibility.

- Donors must explicitly recognize that each country will manifest unique conditions for privatization (political, socio-economic, market/economic structure, policy). Assistance programs for privatization must be tailored and customized to each country.

- Donors must facilitate privatization programs rather than "force" them upon Governments.

- Donors should assist with those aspects of the privatization program in which they have distinct competence, relative to both host-country entities/individuals and other donors.

- Donors should recognize the absorptive capacity of a given country or government, especially with regard to the use of expatriate technical assistance.

- Donors must carefully manage their "visibility" in privatization programs so that they: (i) do not raise false expectations and then are perceived not to have delivered; and (ii) are not seen to be the driving force behind the program.

5. TARGETS OF OPPORTUNITY FOR USAID

5.1 Introduction

In this chapter, selected areas in which USAID could have an effective role in supporting privatization in Sub-Saharan Africa are identified and assessed. Emphasis is placed on: (i) identifying those areas in which USAID can best support privatization in Africa, relative to other sources of such assistance; and (ii) providing a preliminary indication of the manner in which USAID's assistance could be provided. These areas of opportunity are derived both from the assessment of the ONI-funded country activities (Chapter 2) and from the general lessons learned (Chapter 4).

The criteria used to identify whether a particular area represents an opportunity for USAID assistance are as follows.

- It is an important area for African privatization. That is, it addresses one or more of the critical success factors identified in Chapter 4.
- USAID has past experience in the area, is seen as providing credible support, and USAID can be effective.
- USAID has comparative advantage in providing such support, both relative to other donors and/or government.
- The opportunity area supports and is consistent with USAID's overall strategy and policy, as defined in "Strategies for Sustainable Development", USAID, January 1994.

The selected areas of opportunity identified are as follows.

1. Institutional framework for privatization program design and implementation.
2. Broadening share ownership.
3. Compensating the "losers" from the privatization, particularly labor.
4. Governance, especially the legal elements such as legal framework, appropriate laws and the rule of law.
5. Privatization of infrastructure industries, such as telecommunications and railways, which are often thought to constitute "natural" monopolies.

This list of opportunities is by no means exhaustive. However, it is assumed that USAID must be selective for the following reasons.

a. Scarcity of Resources. Providing assistance to privatization programs is resource-intensive. The programs occur over relatively long time frames, the issues are complex, and donors need to dedicate senior-level resources (which are scarce and must be prudently allocated). Thus, USAID needs to be selective, and choose only those opportunities where it is willing to dedicate and sustain the required resources, and where USAID can "make a difference" relative to other sources of assistance.

b. Consistency with USAID Policy. Not all areas of opportunity are equally consistent with USAID's policy and strategy. They vary in the degree to which they support different elements of the policy framework.

c. Political Intensity. Some areas of support to privatization require an in-depth understanding of the country's political dynamics, given the highly political nature of privatization in Africa. Donors need to have significant "clout" in order to help bring about a fundamental shift the balance of political resolve. USAID is not in such a position, nor does it wish to be, in a number of African countries. This will necessarily restrict what type of issue USAID chooses to address in a given country.

5.2 Selected Areas of Opportunity for USAID

Each of the five areas of opportunity, in which USAID can "make a difference" with regards to privatization in Africa, are discussed below. Furthermore, the targets of opportunity are not mutually exclusive, but rather overlap and have some degree of synergy among them. For each area: (i) the nature of the opportunity is defined; (ii) what it achieves in terms of the goals of the overall privatization program is identified; (iii) the nature and degree of its "fit" with USAID's policy is discussed; and (iv) the manner in which USAID might provide assistance is briefly highlighted.

5.2.1 Institutional Framework

(Draft forthcoming mid-August)

5.2.2 Broadening Share Ownership (BSO)

Within the context of privatization, broadening share ownership (BSO) is the increased participation of the general population and/or specific target groups in the privatization process through some form of ownership in the divested enterprise. Due to a number of enabling environment factors, domestic savings in most African nations are not directed to the formal economy. Rather, significant financial resources are often mobilized within the informal sector in terms of both business initiatives and savings.

BSO addresses this situation by providing an efficient and viable mechanism to: (i) mobilize and channel potentially significant financing into the formal economy; (ii) generate support for the privatization program by demonstrating that privatization can benefit citizens, not just foreigners or elite nationals; (iii) enable management and/or employees to have an ownership stake in an enterprise; and (iv) allow for the participation of socially, economically and/or geographically disadvantaged groups.

Broadening of share ownership also promotes the development and strengthening of emerging capital markets which in turn facilitate privatization of SOEs and leads to sustainable development.

In defining an approach to broadening share ownership and determining which methods are appropriate, governments need to balance the notion of share allocation, and its resulting political and social benefits, with the technical and financial requirements of the privatization candidate. In addition, the government's desired financial returns from the privatization process must be addressed. Broadening share ownership in the privatization process can take a variety of forms, the appropriateness of which is dependent upon a number of political, enabling environment and enterprise-specific factors. Mechanisms include: the use of public offerings; utilization of financial intermediaries and trusts; targeting of management, employees and special interest groups; and creation of mass privatization/voucher schemes.

Public offerings promote transparency in the privatization process, mobilize capital and strengthen financial markets, while creating a new class of private sector equity holders. Public offerings require a nascent capital market or an alternative distribution/trading network such as bank or post office branches. Strong regulatory and operational frameworks are required to control the process, protect small investors and maintain public confidence in the program's legitimacy. However, based upon the need for a technical partner and/or a new management team, transactions may be structured to provide a "shareholder of reference" with a majority stake followed by a public offering for the remaining equity. Share ownership through public offerings assumes a certain level of investor appreciation of the long-term investment benefits and risks associated with share ownership, along with an understanding of the mechanics required to be a share owner. This in turn assumes a strong public education/communications capability on the part of the seller (that is, the government) in order to generate enterprise name recognition and broad-based interest and participation.

Broad-based, indirect ownership of shares may be accomplished through the participation of financial intermediaries such as insurance companies or pension funds. Not only can such intermediaries offer a significant source of capital, but potential investors with savings who might otherwise not participate in the "market" may benefit from the privatization program through their participation in such funds.

Privatization trust funds also offer the opportunity for broad participation, particularly appropriate for an environment where there are no capital markets. Privatization trust funds can take a variety of forms and should be developed specifically for a particular country, taking into account the legal and regulatory framework. A privatization fund can be established as an investment fund similar to a mutual fund. Once the portfolio has been established, the fund can be listed on the stock exchange, shares removed from direct government control, and shares/units sold to the public.

Direct ownership by specific target groups such as management, employees and special interests through management buy-outs (MBOs), ESOPs and restricted tenders are political decisions with economic merit aimed to achieve the social objectives of creating a new class of share holders. In the case of MBOs, management must have the demonstrated capability to "turnaround" or maintain the profitability of the company which itself will not require fresh investment capital. Strong cash flow potential is also important. Often, potential managers turned owners benefit from advisory assistance. Employee participation requires a profitable company. ESOP-type mechanisms can accompany virtually any type of divestiture strategy. Employee/management participation offers powerful incentives to improve company operations while diffusing opposition to the privatization process. Other special target groups such as disadvantaged ethnic groups, farmers in the case of agribusiness enterprises or residents of an area whose economy depends on the privatized candidate, can be built into the divestiture strategy.

Mass privatization/voucher schemes, while appropriate for countries with undeveloped capital markets, appear to be most effective in countries where the government has foregone its objective of raising cash (most voucher programs in the NIS and Eastern Europe have included free distribution of vouchers), the volume of SOEs to be sold is fairly significant, and the program is implemented at a rapid pace. Such schemes, while not automatically achieving micro-enterprise goals, do result in a broadened class of stakeholders in the economy as well as eliminate the need for government to subsidize the SOE. Mass privatization programs require a strong policy and operational framework to protect investors and ensure transparency and fair distribution. A number of African countries have considered this form of privatization, concluding that it would not meet the government's financial objectives and would be too difficult to administer.

The development of Africa's private sector requires the mobilization of savings and the channeling of the funds into active and vigorous financial markets. USAID is able to support this requirement through cost effective, results-oriented assistance which allows diverse groups to participate on equal terms in their nation's privatization efforts. Assistance should focus upon broadening share ownership of SOEs through direct and active participation of the public in the country's economy.

USAID can contribute to the enabling environment in African countries through policy, operations, regulatory and legislative measures designed to develop and improve financial markets, including the promotion of BSO-specific financial instruments such as mutual funds, privatization trust funds, and pension and insurance plans. Through public relations, education and training programs, USAID has the ability to promote BSO not only at the public and government levels but also to the organizations entrusted with the divestitures. Continued gentle persuasion is necessary to convince governments of the benefits of divesting SOEs even at the expense of low cash proceeds or loss of "strategic" assets. Programs must also be aimed at the general population to illustrate the individual and national benefits associated with long-term investing in the nation's economy. At the same time, the associated risks of investing must be explained.

To implement a BSO program, USAID can promote technical assistance which includes wide-spread offerings as integral to the enterprise transaction structure. As part of this, a savings/demand analysis should be conducted to develop an investor base and to serve as the basis of a public relations campaign. When deemed appropriate, factors such as gender, ethnic identity and geographic locale should be taken into account.

The frameworks and initial financing for management buy-outs (MBOs) and employee stock option plans (ESOPs) must be constructed so that they can be efficiently and effectively implemented in appropriate divestitures. Training of SOE managers will make MBOs and ESOPs more practical while enhancing the value of SOEs, as will the provision of initial business advisory services.

5.2.3 Compensating the Losers

Labor commonly is one of the groups which is most ardently opposed to privatization due to the perception that employment, income and other services will be lost as a result of privatization. Experience demonstrates that in many circumstances it is absolutely essential to address employee concern at the earliest time of initiating and implementing a privatization program. Otherwise, the privatization program will stall due to labor opposition directly, and/or the increased "politicization" of the privatization process.

The negative consequences on labor of privatization can extend beyond loss of income and employment, and include the loss of important social services such as housing, educational allowances and access the health care. Traditional "plantation-style" industries such as railroads and more recently telecommunications and postal companies have provided a wide range of such services to its employees at little or no cost. In addition, in Africa and other developing countries, prospects for alternative employment in the formal sector are low and employees tend to support a large extended family. The social dislocation of job loss, thus, affects the entire family. Finally, employment in state-owned enterprises has often formed the basis of political patronage. Privatization encounters political opposition not only because of job loss per se, but also due to the loss of a mechanism by which politicians can "reward" individuals for political support.

While the long term economic benefits of privatization should outweigh the short-term dislocation costs in order for privatization to proceed, governments and donors alike need to develop programs which mitigate negative socio-economic consequences and compensate the losers[13]. This is required both to reduce a potential obstacle to the privatization process (that is, labor resistance) and because it is an appropriate role for the State to address specific, short-term dislocations.

[13] Virtually all of the recent, more promising privatization programs in Africa which are act the design or early implementation stage contain some "social safety net" component -- for example, Tanzania, Benin and Cape Verde).

In developing compensatory programs, governments and donors must ensure that the program is short-term in duration, addresses the specific negative consequences of privatization, and does not seek to establish a quasi-permanent social "safety-net" or build institutions and/or mechanisms which do not have "sunset" provisions.

In any privatization, the labor issue should be addressed by first starting a process of productive dialogue in which management and/or Government communicate to workers, worker associations or unions the merits and rationale of privatization and the measures being developed to compensate the losers. Thereafter, the compensatory program can include a number of elements including: (i) severance packages, enhanced pension programs, employee ownership programs (ESOPs) or other mechanisms which contribute to income; (ii) outplacement counselling and related services and selective retraining assistance; and (iii) establishment of entrepreneur credit funds and other targeted financing schemes to assist retrenched workers in starting businesses. In addition, the privatization methods which are implemented should emphasize the "spinning off" of non-core businesses, which employees are in turn eligible to purchase[14].

Governments have also addressed the loss of employment issue directly, by either requiring that the purchaser guarantee a certain level of employment over a specific time period, or by government absorbing retrenched labor in other parts of the civil service. However, both of these mechanisms merely postpone absorbing the labor dislocation, the cost of which will have to borne sooner or later. In addition, longer term adjustments include measures to increase the employment base in the formal sector. However, such adjustment is longer term in nature and thus, is not considered compensation for short-term dislocation.

The funding of a number of the income-related measures can be accomplished through ear-marking some of the privatization sales proceeds. A number of countries have funded the severance payments in such a manner, or paid early retirement benefits from this source. In addition, these funds could underwrite an entrepreneur's fund. Finally, sales proceeds might be used to guarantee a "floor" price for shares in an ESOP so as to mitigate the chances that retrenched workers were compensated by shares that produce no dividends and/or loose face value over time.

USAID has a nascent track record in providing such assistance to privatization in Africa. For example, railway privatization projects that have been designed for both Mozambique and Malawi contain many of the compensatory and mitigative measures identified above[15]. USAID also has relative comparative advantage in such areas as: (i) ESOPs and pension schemes, for which the US has been at the forefront for many years; (ii) the communications and information dissemination programs surrounding privatization and the impact on employment; (iii) retraining and human resources development, a traditional strength of USAID in Africa; and (iv) more

[14] These businesses should be available for purchase by workers on favorable terms, or at least on a "right of first refusal" basis. In addition, the company being privatized can often become the first significant customer for the spun-off business, representing a steady flow of revenue from which repayment can be funded.

[15] Regional Railways Restructuring Project (Malawi Railways Component) and the CFM: Labor and Asset Redeployment Project (Mozambique).

recently, establishment of specialized funds and trusts in support of privatization, capital market development and resource mobilization. In addition, USAID has greater flexibility than many other donors to sponsor improved severance packages, income compensation schemes and special funds through ear-marking the use of counterpart funds generated by NPA (non-project assistance) and/or through policy benchmarks established for NPA disbursement.

Compensating the losers supports USAID's strategy for building democracy (for example, protection of the rights of workers, and partnering with trade unions) and for encouraging broad-based economic growth (for example, building human skills and capacities, and supporting micro-enterprise and small business).

USAID's assistance in this area could take a number of forms. It could either be by theme (for example, ESOPs and pension schemes) and/or by industry sector or significant firm (for example, railways, telecommunications or large agro-industrial complexes). A combination of the two is appropriate in countries where USAID has a strong presence and is actively engaged in national level policy dialogue. Assistance could include the following.

- Technical assistance and information dissemination in support of productive dialogue with labor and its representatives.
- Technical assistance and financial support (probably through NPA) for severance packages, ESOPs and other income support mechanisms for retrenched workers.
- Technical assistance and financial support for outplacement services and selective retraining.
- Technical assistance and financial support for entrepreneur credit funds, trusts and other specialized financing schemes.

5.2.4 Legal Aspects of Governance

The specific laws and legal aspects of governance which support privatization are complex, multi-layered and require explicit recognition in the privatization process. Unfortunately, to date in Africa, the legal aspects are often addressed in a cursory manner, and have thus contributed only marginally to the relative success of privatization programs.

Legal elements which are critical to successful privatization include: (i) rule of law -- the processes, procedures and public law bodies which provide an impartial, transparent, stable and predictable basis for applying the legal principles which underlie the relationships between private agents, the State and other parts of the public sector; (ii) legal framework for private sector development (PSD), including laws which protect competition and create a "level playing field", such as price liberalization, anti-trust provisions, deregulation and delicensing, regulation of monopolies and trade legislation, and business legislation such as property law, contract law, company law, liquidation and bankruptcy law, and environmental legislation; and (iii) enabling legislation for privatization which creates an overall legal basis for privatization and divestiture and establishes the institutional entities charged with implementing the legislation.

Rule of law is a prerequisite for successful privatization. Without rule of law, investors in privatized companies have no guarantee that the assets or shares that they have acquired have any sustainable value and/or will not be seized and ownership lost. Without rule of law, fewer investors will be interested in the privatization program, and those that are, will offer lower prices as reflection of the uncertainty that weak rule of law constitutes.

Creation of a enabling legal environment for private sector development is an important ingredient in privatization. However, the degree to which such legislation needs to be in place prior to privatization is a matter of judgement and will vary by country. To enact all the types of legislation to support private sector development would take many years to implement and delay the process of privatization. Thus, priorities must be established for enabling legislation and relevant authorities should concentrate on the core part of the legal framework which must be in place for divestiture to proceed.

Likewise, the proper sequencing of regulatory reform and divestiture also tends to be critical to a privatization program's success. In order to determine the price they are willing to pay, investors need to know under what regulatory regime the company will be operating. This regime should thus be determined prior to divestiture. Uncertainty with regard to the applicable regulatory regime would result in lower investor interest and sale price.

Whether a country should enact specific divestiture or privatization laws or not depends on its political situation, its legal traditions, the extent of the divestiture program, and the nature of the enterprises to be divested. The two key issues are: (i) whether legislative enactments are needed to authorize or facilitate divestiture; and (ii) if so, should these legislative provisions be enacted as amendments to relevant laws or packaged as a specific divestiture law. As a general rule, new legislation should not be enacted where existing laws (or the amendment thereof) would suffice. However, some countries have opted to enact divestiture laws regardless, in order to enhance up-front and explicit political support and commitment for the process, increase visibility and accountability of the agency in charge of implementing the divestitures, and to add to the general provisions of the law other changes in the legal regime that may facilitate the divestiture process. The dangers inherent in a specific privatization law include lengthy delays needed to secure parliamentary approval, overspecification of the law, and excessive parliamentary interference in the process.

The divestiture law itself should thus be an enabling law, giving the government or privatization agency broad powers to privatize, while avoiding restrictions that might unduly tie the implementing agencies' hands and delay the process. While flexible, the legal framework should establish basic safeguards guaranteeing the integrity and efficiency of the process. Clear, flexible and competitive divestiture methods carried out in a transparent manner by accountable officials will go a long way to ensure the success of the privatization program.

Rule of law and the appropriate legal framework for divestiture are critical to the success of privatization in Africa. USAID is a credible supplier of assistance and can have comparative advantage relative to other donors. USAID is a leader in providing support for democracy and governance, and the US is a recognized technical leader in legal aspects related to private sector development such as anti-trust, company-related laws and the regulation/deregulation of natural monopolies.

USAID can assist with establishment of rule of law by supporting requisite constitutional changes, facilitating democratically elected legislatures, and providing specific technical assistance to the legal system overall and independent judiciaries in particular to ensure impartiality, accountability and transparency. This in consistent with USAID's strategy of building democracy.

In addition, USAID can provide support to the creation of enabling legislation for private sector development, and where appropriate, privatization-specific legislation. This is consistent with USAID's strategy of encouraging broad-based economic growth, especially through strengthening economic and political institutions critical to good governance and encouraging the effective functioning of markets. This latter goal is further supported through creation of an enabling environment, addressing weak or absent institutions needed in a market economy, and technical assistance for the privatization of state-owned enterprises.

USAID's support can include a combination of relevant technical assistance, training and human resources development, institution building/strengthening, and information dissemination programs in three main topic areas.

- Rule of Law: constitutional changes; democratically elected legislatures; promotion of good governance; and technical and procedural development of the judiciary.

- Enabling Legislation for PSD: promote policy reform which supports the appropriate prioritization and sequencing of reforms and the inclusion of mechanisms which broaden ownership such as ESOPs, special funds and unit trusts; and technical assistance to develop the substantive content of the laws, and to design and implement the broadening share ownership mechanisms.

- Privatization-Specific Legislation: to create a privatization agency and supporting institutional framework and procedures; to specify the appropriate methods of privatization and candidates for privatization; and to foster open communication and wide dissemination of the privatization policy and related legislation.

5.2.5 Infrastructure Industries

Infrastructure industries such as telecommunications and railways are often considered to be "natural" monopolies. Traditionally, in Africa, they have been deemed "strategic" and have not been candidates for privatization. This is in part due to the fact that these industries: (i) are fundamental to economic growth, (ii) employ large numbers of people; (iii) can have a role in national security; and (iv) have significant and widespread people-level impact.

However, despite the earlier resistance to privatizing these sectors, many countries have more recently targeted them for privatization and have been successful. The catalysts for such a change in policy is in part because of the growing evidence that technical solutions to privatizing these industries are available and have proven successful in practice, and the fact that these large companies place such a large burden on public finances that they become a priority for privatization out of financial necessity.

The concern with "natural" monopolies and the creation a private monopoly where a public monopoly existed has been overcome through: (i) selective restructuring and segmentation of the sectors, such as creation of a public track authority but private operation of passenger and freight services respectively in the rail sector, or in telecommunications, requiring that different private operators be established for regional versus international service[16]; (ii) revision of national legislation to eliminate the formerly legislated government monopoly and explicitly encourage private sector participation and competition; and (iii) the establishment of a post-privatization oversight body and related regulatory framework to monitor performance against agreed parameters, such as a ceiling on the return on assets or a maximum allowed profit margin over costs.

The United States and USAID have experience in these sectors, are credible providers of relevant technical assistance, and
can attain comparative advantage versus other donors. The United States has one of the longest experiences with deregulation and privatization of telecommunications (AT&T break-up) and railways, and its private industries are world leaders in technological know-how and in manufacturing products for these sectors. USAID (and TDA) have a track record in providing assistance to these sectors worldwide and more recently, in Africa as well. For example, assistance with telecommunications in Southern Africa regionally and Zambia at the country level, and in Mozambique, Malawi, Zimbabwe and Swaziland in the rail sector. Finally, no other donor seems to have concentrated its efforts on these sectors in Africa, although in individual countries donors such as the Caisse de Development (France) have undertaken efforts to further the commercial interests of national equipment suppliers.

Assistance in these sectors is consistent with USAID's policy and strategy. By making these sectors more efficient and effective, broad-based economic growth will be encouraged. This emanates in part from the fact that these sectors have been grossly mismanaged in the past, there

[16] Such restructuring efforts have been successful in larger countries in enhancing competitive conditions the post-privatization period, but have a more limited effect on competition in smaller countries where the scale of operations is too limited to support effective market segmentation and multiple operators.

is substantial scope for improved performance, and they are widespread in their impact on the economy and people. These reforms will strengthen markets, expand access and opportunity for individuals and businesses, promote private sector development, and enhance the empowerment of people. For example, telecommunications are key in promoting a sense of national identity, and facilitates elections, democracy, governance and commerce. Likewise, railways link the national economy, facilitate trade and communications, and can substantially reduce the end-consumer prices for important inputs such as fertilizers and fuel which the vast majority of the nation consumes.

Assistance provided by USAID can occur at several levels.

- Encourage policy reform to promote privatization in these sectors, by making it a part of on-going policy dialogue and/or NPA conditionality.

- Provide technical assistance and training to establish the appropriate regulatory and institutional framework for privatizing these sectors and creating competitive conditions in the post-privatization period.

- Provide technical assistance to help restructure enterprises in the rail and telecommunications sectors in order "right-size" the companies, segment the industry into competitive components, and address legal and financial liability restructuring issues.

- Provide technical and financial assistance to provide a social safety net and compensate the "losers" in the privatization of these large sectors. Measures could include: outplacement services; retraining; severance package enhancement; credit funds to support entrepreneurs which emerge from retrenched labor; and designing programs which address that fact that railways (and telecommunications) companies have often provided a social support system (eg, clinics, schools, housing) in addition to employment.

Annex A: Bibliography

Papers and Reports

Ahene, Rexford and Katz, Bernard: *Privatization and Investment in Sub-Saharan Africa*, Praeger, 1992.

Ambrose, William, Hennemeyer, Paul and Chapon, Jean-Paul: *Privatizing Telecommunications Systems: Business Opportunities in Developing Countries*, IFC Discussion Paper Number 10, 1990.

Berg, Elliot. *Privatization Strategies in Africa: The Need for a Reappraisal*, (Prepared for the African Development Bank), March 1992.

Berg, Elliot. DAI, *Privatization in Sub-Saharan Africa - Results, Prospects and New Approaches*, July 1993.

Berg, Elliot; Hogan, Daniel; Ludvik, Carl; Graham, Melissa. DAI, *Privatization and Development Project Midterm Evaluation: Main Report and Country Studies*, February 1994.

Clifford, Veronica: *Implementing Privatization Policy in Developing Countries: A Selected Literature Review* (draft), Implementing Policy Change Project (USAID), September, 1992.

Cowan, L. Gray. *Privatization in Africa: An Update*, (Prepared for AFR/ONI USAID), January 1992.

Cowan, L. Gray: *Privatization in the Developing World*, Praeger, 1990.

Drum, Bernard. *Privatization in Africa*, Columbia Journal of World Business, March 1993.

Galenson, Alice and Thompson, Louis: *Forms of Private Sector Participation in Railways*, World Bank Report TWU9, December, 1993.

Gayle, Dennis and Goodrich, Jonathan (ed): *Privatization and Deregulation in Global Perspective*, Quorum Books, 1990.

Giroday, Jean de la. Center for Privatization, *Mission on Privatization: Senegal*, (Prepared for the Bureau of Private Enterprise USAID), February 1987.

Government of Cameroon. *La Privatisation au Cameroun*, 1989.

Government of Cameroon, *Expose sur l'Etat d'Execution du Programme de Privatisation au Cameroun*, December 1993.

41

Government of Senegal, *Rapport D'Etape Portant Sur le Programme de Privatisation au Senegal au 31/12/91*, December 1991.

Grosh, Barbara and Mukandala, Rwekaza: *State-Owned Enterprises in Africa*, Lynne Rienner Publishers, 1994.

Guislain, Pierre: *Divestiture of State Enterprises: An Overview of the Legal Framework*, World Bank Technical Paper Number 186, 1992.

Huff, Lee and Thompson, Louis: *Techniques for Railway Restructuring*, World Bank WPS 380, October, 1989.

Jones, Leroy, Tandon, Pankaj, and Vogelsang, Ingo: *"Selling Public Enterprises: A Cost-Benefit Methodology"*, The MIT Press, 1990.

Lee, Barbara: *Should Employee Participation be Part of Privatization*, Working Paper 664, Country Economics Department, World Bank, May, 1991.

Likeng, Mandeny. President of the Sub-Committee on Privatization, Cameroon. Personal Correspondence.

Ordover, Janusz and Pittman, Russell: *Competition Policy for Natural Monopolies in a Developing Market Economy*, Draft Paper, U.S. Department of Justice, 1993.

Price Waterhouse, International Privatization Group. *Privatization in the Republic of Burundi - A Preliminary Assessment*, February 1993.

Price Waterhouse, International Privatization Group. *Mitigating the Short Term Negative Impacts of Privatization - Compensatory Programs During Economic Transition*, January 1994.

Price Waterhouse, International Privatization Group. *Privatization in Retrospect: USAID Programs and Lessons Learned*, 1993.

Price Waterhouse International Privatization Group. *Trends in Privatization and Development*, December 1993.

Privatization Yearbook 1994.

SRI International. *Lessons Learned from Worldwide Privatization Experience Relevant to Zambia*, (Prepared for AFR/ONI and USAID/Zambia), August 1993.

USAID, *Africa: Growth Renewed, Hope Rekindled - A Report on the Performance of the Development Fund for Africa 1988 - 1992.*

42

USAID/Praia, Fax from Barbara Kennedy. Memorandum of an article from "A Semana" no. 122 entitled "*Sergio Centeio, Director of the Privatization Committee (GARSEE) provided the following information regarding the privatization process*", September 1993.

USAID: *Strategies for Sustainable Development*, January, 1994.

U.S. Embassy/Yaounde, Personal Correspondence, May 1994.

United Nations, *Accounting, Valuation and Privatization*, 1993.

Vuylsteke, Charles: *"Techniques of Privatization of State-Owned Enterprises: Volume I: Methods and Implementation"*, World Bank Technical Paper Number 88, July 1988.

Wilson, Ernest: *Political and Institutional Issues Involved in Designing and Implementing a Country Privatization Program*, Center for Privatization (USAID), October, 1988.

The World Bank, Country Economics Department. *Privatization: The Lessons of Experience*, April 1992.

Zambia Privatisation Agency. *Progress Report No. 2*, 1 January 1993 - 30 June 1993.

Zambia Privatisation Agency. *Tranche 1 Status Report*, October 6, 1993.

<u>Press Articles</u>

Agence France Press, February 19, 1994.

Financial News, April 1, 1993.

Global Money Management, March 21, 1994.

GBD Radio Text Broadcast, *"Government sells holdings in seven state-owned companies"*, February 1994.

Ghazali, Fadzil. "Business Times", *Malaysia: Tanzania Hopes to Follow our Privatization Scheme*, April 12, 1994.

Global Telecom, October 4, 1993.

Market Reports, July 18, 1991.

Market Reports, *"Ghana - Commercial Activity Report '93"*, September 15, 1993.

Nuhu, Alpha. Inter Press Service, September 24, 1993.

-43'

PR Newswire, March 28, 1994.

Xinhua General Overseas News Service, August 26, 1993.

44

Annex B: List of Contacts

Adekaounte, M. Head of Benin Privatization Unit. May 17, 1994.

Aleem, Irfan. Senior Economist. Eastern Africa, Industry and Energy Operations, The World Bank. May 19, 1994.

Azi, Cherif, Senior Operations Officer. Sahelian Department, Industry and Energy Division, The World Bank.

Ba, Demba. Benin. January 11, 1994 & May 13, 1994.

Byam, Gerard. Senior Economist. Public and Private Enterprise Division, Eastern Africa Department, The World Bank. May 15, 1994.

Coolidge, Jacqueline, Enterprise Restructuring Specialist. Public and Private Enterprise Division, Eastern Africa Department, The World Bank. May 15, 1994.

Gates, Jeff. ESOP Specialist. May 19, 1994.

Loupeda, Christian. World Bank Representative, Benin. May 15, 1994.

Saghir, Jamil. World Bank CFSPS, Cote D'Ivoire. May 20, 1994.

Yameyo, Hubert. Head of Burkina Faso Privatization Unit. May 18, 1994.

45

Annex C: Broadening Share Ownership

Assertion: *Targeted AID-funded assistance to facilitate the broadening of share ownership in African countries' privatization programs will have a positive political, economic and social impact.*

A. OVERVIEW

Designing a privatization strategy at both the national program and transaction (enterprise) levels is a complex endeavor requiring the careful balancing of **political, economic and social objectives**. A number of the lessons learned cited in the previous chapter essentially relate to obtaining support of various constituencies through not only transparency but their inclusion in the privatization process. If structured effectively, a strategy which includes broad-based participation in the privatization process will both generate the support the government needs and help in the realization of the government's broader objectives of increasing private sector activity.

Within the context of privatization, broadening share ownership (BSO) is the increased participation of the general population and/or specific target groups in the privatization process through some form of ownership of the company. Broadening of share ownership is a viable mechanism to facilitate privatization in that it serves to:

- mobilize potentially significant financing
- generate support for the privatization program by demonstrating that it is a program for the citizens and not just for foreigners or elite nationals
- enable management and/or employees to have an ownership stake in an enterprise
- allow for the participation of economically or socially disadvantaged groups.

In the longer-term, certain broadening share ownership mechanisms will stimulate the development of capital markets, enhance the economic empowerment of the people and lead to sustainable private sector growth.

An undisputable fact for Africa is that sustained economic growth will require increased self-financing capabilities. With world-wide financial resources being stretched by the demand from developing countries and more recently, Eastern Europe and the former Soviet Union, African countries must continue to make concerted efforts to mobilize domestic savings, creating or enabling the creation of attractive investment opportunities. Specific investment opportunities created by a privatization program coupled with an enabling environment will encourage individuals to participate in the formal sector. From the financial sector perspective, it will strengthen domestic resources by mobilizing savings both locally and from Africans living abroad.

An often cited problem is that domestic savings do not exist in sufficient volume in most African countries. Financial resources do exist in Africa but due to a number of enabling environment factors, are often directed towards the informal sector in terms of both business initiatives and savings. In Cameroon, for example, the common perception is that the financial sector is on the brink of bankruptcy (probably true) and no domestics savings exist (questionable). In fact, tontines, which are informal savings mechanisms, represent a very significant source of capital. Moreover, in a country where there is supposedly no capital, a recent private sector bond issue mobilized CFA 2.5 billion from Cameroonian nationals. In Kenya, a demand study estimated potential investment mobilization through public offerings to be KSH 3 billion annually.

The opening of share ownership in privatized enterprises to all levels of society is in fact a principal goal of many African countries' privatization programs. Conversely, the concentration of ownership is a key concern of many African governments with respect to privatization. The applicability of broadening of share ownership in African countries will obviously vary. For each country, economic factors will preclude every citizen's participation unless a free voucher scheme is implemented. In defining an approach and determining which methods are more appropriate, governments will need to balance on the one hand, the notion of share allocation and resulting political and social benefits, with on the other hand, the technical and financial requirements of the privatization candidate as well as the government's desired financial returns from the privatization process.

B. Broadening Share Ownership Mechanisms and Applicability within the African Context

Broadening share ownership (BSO) in the privatization process can take a variety of forms, the appropriateness of which is dependent on a number of political, enabling environment and enterprise-specific factors. Below we present a number of mechanisms which can encourage wide spread ownership, drawing on examples and issues relating to Africa in particular.

1. Public Offerings

Broad-based, direct ownership of an enterprise's shares may be accomplished through public offerings. They serve to mobilize capital and strengthen the financial markets while creating a new class of private sector equity holders. They also encourage transparency in the divestiture process.

This form of privatization requires at least nascent capital markets or an alternative distribution/trading network which can be created from institutions such as banks or post office branches. Such a network is essential to ensure both the success of the placement and the subsequent liquidity of the shares. Public offerings require a strong regulatory and operational framework to both control the process and protect the interests of the small investors. Corporate governance is also critical.

47

Czechoslovakia is a good case study in terms of mechanics although it is recognized that incidences of fraud and mismanagement have overshadowed the process. In its mass privatization program, Czechoslovakia included both the development of a stock exchange, which may not yet be appropriate for some African countries, and a national over-the-counter network around the country to provide a trading mechanism. This network matched buy-order requests every six weeks using the post office network. Such a network is implementable within the African context with appropriate assistance to establish a strong regulatory and operation framework.

Nigeria, Cote d'Ivoire and Kenya have taken advantage of their stock markets to use public offerings to sell state-owned enterprise shares. In the case of Nigeria, transactions are structured to ensure broad-based participation by limiting the number of shares individuals can purchase. As indicated in Section III, over 400,000 new shareholders have been created since privatization began. 80% of the shares sold were to smaller investors who purchased 1000 shares or less. Other measures implemented by the government to prevent the concentration of shares included restricting the transfer of shares during the first five years. (Columbia Journal 3/93 Drum) This may discourage both ownership concentration and speculation. However, it inhibits liquidity which is essential for African small shareholders and can in fact serve as a disincentive to broad-based participation. The incentive system employed by the U.K. in a number of transactions including the British Telecommunications deal is perhaps more appropriate for many African countries. Rather than restrict trading, incentives to retain shares for three years with bonuses payable at the end of that period were implemented.

Cote d'Ivoire intends to use IPOs in the new privatization program to both develop their capital markets and to pursue a strategy of broadening share ownership. 40% of shares of enterprises to be privatized via IPOs will be targeted to the small investor. In 1992, privatization contributed 20% to the stock exchange's capitalization. IPOs completed included minority divestitures of CAPRAL, a food processing company (24%) and the electricity company, CIE (24%). In the case of CIE, the company created a special plan for employee participation. About 20% was allocated to employees. The share price was discounted and financing was arranged by the company. Aware of the need for public education on this type of investment, the government's prospectuses for public offerings generally include educational information to help the "first time" investor.

Kenya has also taken advantage of its capital markets although the Nairobi stock exchange remains influenced by institutional investor trading.[17] Successful public offerings have included the Kenya Commercial Bank, Uchumi Supermarkets and the Housing Finance Corporation of Kenya. The Uchumi issue of only 40% was done on the strategy that the government wanted "to test the waters" and establish a price before divesting additional equity. This was not clearly articulated to potential investors who may have participated under the assumption that the Government would retain its majority holdings. Likewise, the KCB issue

[17] U.N., 1993.

48

still involved government control, which investors believe explains why KCB shares are down-valued by the market as compared with similar banks.[18]

In Burkina Faso with no capital markets to speak of, the government is considering the privatization of 49% of ONATEL, the state-owned telephone entity, through a wide-spread offering.[19] In Tanzania, 50% of the national brewery was sold to a South Africa firm which is expected to bring in both needed capital and technical expertise. The remaining equity will be sold through a wide spread offering at a later date. In Benin, sales agreements with foreign investors for a number of transactions included the requirement that within a specified amount of time, a percentage of shares would be sold to the public through banks or notaries.

Public offerings require, at the enterprise level, strong financial performance and company name recognition to generate broad-based interest and participation. However, based upon the need for a technical partner and/or a new management team, transactions may be structured to provide a "shareholder of reference" with a majority stake followed by a public offering for the remaining equity. Morocco's privatization program has completed a number of successful transactions using this approach.

Strong financial performance or prospects is a critical requirement. Mobilizing the savings of citizens only to have an enterprise fail would have enormous negative consequences both for the privatization program and politically. This is a constraint currently faced by Tanzania. On the one hand, because of concern about a potential concentration of wealth, broadening share ownership is a principal objective of the privatization program. On the other hand, most of the enterprises slated for privatization are not profitable and their future viability remains uncertain.

Share ownership through public offerings assumes a certain level of investor appreciation of the long-term investment benefits and risks associated with share ownership along with an understanding of the mechanics required to be a share owner. This in turn assumes a strong public education/communications capability on the part of the seller (i.e. the government), and as mentioned above, a strong placement network. An experience in Cameroon using this method highlights potential constraints in this regard.

Cameroon does not have a stock market nor securities brokers. One of the enterprises on Cameroon's initial privatization "tranche" is Chococam, a food processing entity which is profitable and appears to have good future prospects. The government's equity totals about 15%. The principal shareholder already enjoys a controlling interest as well as commercial contracts and has no desire to purchase the remaining 15%. The government decided to sell the shares in a public offering using the state-owned commercial banks as placement agents. The results have not been successful. The placement agents did not embark on adequate marketing nor tap existing clients, no doubt due to their inexperience in this area, the relatively small size of the offering, the relatively unknown reputation of the company and the placement fee (3%) vs. earning spreads which are generally higher.

---

[18] ibid.

[19] Global Telecoom, 1993

Constraints also surfaced which relate to the orientation of the Cameroonian investor. As most Cameroonian private companies, although legally corporations, are closely held family enterprises, the notion of owning token equity in a company is foreign, particularly when it brings no decision-making authority. In addition, Cameroonians traditionally invest in short-term assets rather than holding instruments which need to mature and/or which are not easily exchangeable. Hence tontines are the preferred investment vehicle since within a relatively short time frame, a significant amount of cash can be raised and invested in a commercial activity with a quick return such as trade. However, given the tremendous success of the private sector bond issue discussed above, it is highly conceivable that an equity offering could be successful if the size were attractive and it were of a well known, profitable company such as the electricity or telecommunications companies.

Another "psychological barrier" to broadening share ownership in Africa is the individual's orientation with respect to the private vs. the public sectors. Countries (particularly former socialist ones such as Benin and Tanzania) whose governments have traditionally taken care of their citizens, creating infinite public sector positions and essentially a culture whereby it was an honor to be a public servant, must now convince the public of the merits of a market economy and investing in private sector growth.

The frequent themes in Morocco's public relations campaigns for privatization include "Invest in Morocco's future...Ensure security in your future years...Be a Shareowner..." Under the assumption that African countries have no option but to tap individual, domestic savings to assist in the financing of the economy, major communications efforts accompanied by attractive investment opportunities, broad-based participation incentives such as maximum share allocation and bonuses for share retention, and a strong regulatory and operation framework to protect investors are essential both for the privatization program and for sustainable private sector growth.

2. Financial Intermediaries and Trusts

Broad-based, indirect ownership of shares may be accomplished through the participation of a financial intermediary such as insurance companies or pension funds. Not only can such intermediaries offer a significant source of capital, but potential investors with savings who might otherwise not participate in the "market" may benefit from the privatization program through their participation in such funds. The external and enterprise-specific factors as described above apply here as well.

Privatization Trust Funds can also offer the opportunity for broad participation, particularly appropriate for an environment where there are no capital markets. Privatization trust funds can take a variety of forms and should be developed specifically for a particular country, taking into account the legal and regulatory framework. Privatization trust funds can "underwrite" (if financing is available) or "warehouse" a minority percentage of enterprises' shares, selling them to the public at large at the appropriate time. A privatization fund can also be established as an investment fund similar to a mutual fund - once the portfolio has been established, the fund can sell shares/units to the public. Such a fund can also be listed on a country's stock exchange.

50

Any type of fund requires a strong regulatory and operational framework to protect individual investors.

Establishment of a privatization trust/investment funds both enables the shares to be removed from direct government control (i.e. off the books of the Ministry "tutelle" or the Ministry of Finance) and creates a mechanism whereby the population can participate. If the fund is serving as a warehouse, it requires a decision on the part of the government to not expect financial returns until such time as the fund begins to sell shares or units. However, if timed appropriately, the sale of shares from such funds may bring in higher sales revenues than would have been the case when the majority of the enterprise was divested. The fund should be managed privately and decisions on whether to accept shares in the fund should be made by the fund manager based upon the suitability of the proposed investments.

Kenya has been studying the possibilities of creating a privatization investment fund which would include minority shares to be divested by the government. The fund would be listed on the Nairobi stock exchange. Tanzania and Uganda are considering the establishment of privatization trust funds; the World Bank will be providing close advice in designing country specific frameworks in this regard. Zambia has already passed legislation and put the regulatory framework in place. The objective of the Zambian fund is the acquisition of shares in newly privatized enterprises for subsequent sale by public offering. The fund is not to act as an underwriter of share offerings, but rather to warehouse shares until such time as public flotation is appropriate and sales proceeds can be maximized. Proceeds from the sales are to be transferred to the Privatization Revenue Account. It is expected that the fund will become operational once Tranche 2 privatizations are well underway.

Cape Verde is considering the establishment of risk capital funds for both the privatization program and private sector development in general. Hoping to attract the Cape Verdean Community abroad, two funds will be created, targeting emigres to the U.S. and Europe respectively.

3. Management, Employees and Special Interest Groups

Direct ownership by specific target groups such as management, employees and special interests through management buy-outs, ESOPs and restricted tenders are political decisions with economic merit aimed to achieve the social objectives of creating a new class of stakeholders.

In the case of MBOs, management must have the demonstrated capability to "turnaround" or maintain the profitability of the company which itself will not require fresh investment capital. Strong cash flow potential is also important. Often, potential managers turned owners may benefit from advisory assistance. Employee participation requires a profitable company, and ESOP-type mechanisms can accompany virtually any type of divestiture strategy. Employee/management participation offers powerful incentives to improve company operations while diffusing opposition to the privatization process.

51

Zambia is an interesting case study in MBOs. MBO bids were received for 15 of the 19 companies in the first privatization tranche. Those not considered serious bids were due to weak business plans, lack of a credible track record, unrealistic cash flows and inability to provide evidence of funding. A number, however, were strong bids but were disregarded because of the payment terms (limited cash up front.) Revised bids submitted by management included foreign technical partners with considerable cash up front. Against the advice of expatriate advisors, these too were disregarded by the Zambia Privatization Agency Board on the basis that the foreign partners were "using" the managers. The end result is that the government lost the opportunity to have strong managers run the companies, gaining significant positive publicity in the process, and lost potential sales. (The companies have been rebid.) No MBOs have been concluded to date.

Other special target groups such as disadvantaged ethnic groups, farmers in the case of agribusiness enterprises or residents of an area whose economy depends on the privatized candidate can be built into the divestiture strategy.

In all these cases, divestiture may be phased through the initial leasing of the assets with an option to purchase at a later date. For example, Poland saw the privatization of 600 enterprises done via lease with option to buy. In addition, financing at below markets rates is often required and terms of payment are generally more favorable, i.e. share discounts, payment allowed in phases.

52

Some brief examples showing the variety of initiatives being undertaken in Africa in this regard include:

Country	Example
Cote d'Ivoire	FOREXI, a small water exploration and drilling company, was privatized via an MBO. In addition to the ESOP component of the electricity transaction, a master plan for ESOPs has been designed for the new privatization program.
Burundi	The privatization of CPI, which provides consultancy services, was via an employee buy-out.
Morocco	The privatization law encourages employee participation and provides for a discount on the share price if the shares are retained for three years. No ESOPs have yet occurred because of financing problems and lack of expertise on structuring a plan.
Tanzania	One of its initial transactions was the sale of a cement company to foreign investors which included a 5% equity tranche for the employees.
Mozambique	The divestiture of the state trucking sector gives priority to small transport operators to purchase a limited number of trucks.
Congo	Although still in the early stages of discussion, an MBO is being considered for the privatization of the electricity company.
Benin	Almost all of the privatizations included a 5% share tranche for employees. The privatization of the national beer company included the subsequent sale by the new owner of the trucks to retrenched workers who had been given priority to handle distribution.
Burkina Faso	Each transaction has included a percentage set aside for employees. None have been accomplished to date.
Cape Verde	It is expected that all transactions will include share allocations for employees. For the companies which were created out of liquidations, advisory assistance was provided to management.

4. Mass Privatization/Voucher Schemes

Mass privatization/voucher schemes have proven to be fairly effective in Eastern Europe and NIS although a number of incidences of fraud and mismanagement have put credibility of the those privatization programs into question. These forms of broadened share ownership, while appropriate for countries with undeveloped capital markets, appear to be most effective in countries where the government has foregone its objective of raising cash (most voucher programs have included free distribution of vouchers), the volume of SOEs to be sold is fairly significant, and the program is implemented at a rapid pace. Such schemes, while not automatically achieving microenterprise goals, do result in a broadened class of stakeholders in the economy as well as eliminate the need for government to subsidize the SOE. Such programs require a strong policy and operation framework to protect investors. A number of African countries have considered this form of privatization, concluding that it would not meet the government's financial objectives and would be too difficult to administer.

-53

C. AID POLICY IMPACT AND IMPLICATIONS FOR ASSISTANCE

Private sector development is a critical AID policy goal for promoting the sustained development of African economies, achieving improved living standards, and enhancing democratization. The development of Africa's private sector requires the mobilization of savings and their channeling into active and vigorous financial markets. Providing assistance to implement measures which will increase the population's opportunity for and participation in the financing of a growing private sector, through equity or debt, will de facto develop the these economies' self-financing capabilities and lesson their dependence on external funds.

Within the context of privatization, policies guiding AID assistance include cost effective, results-oriented assistance which will lead to a transparent and equitable program, allowing broad groups to participate on equal terms. Results-oriented assistance within the African context must be measured beyond executed transactions to the creation of a favorable policy, operation and regulatory environment which stimulates the broadening of share ownership in privatizables, ultimately leading to sustained private sector growth.

AID can have a strong and measurable impact on broadening share ownership (BSO) by providing assistance in a number of areas in which it has a demonstrated track record. These include:

Enabling Environment

- Policy, operational and regulatory measures to develop/improve financial markets including the development of BSO-specific financial instruments

Education/Training

- At Government level - continued gentle persuasion of the benefits of reducing fiscal drain/getting out of industry even if it means low cash proceeds in divestiture

- At Privatization unit level - creative ways to implement BSO

- At population level - individual and national benefits of long-term investing in the economy and associated risks; appreciation of publicly held companies vs. family owned

Implementation

- Savings/demand analysis (by gender if appropriate) to develop investor base and structure PR campaign to tap it.

- Framework for MBOs and Training for SOE managers to be able to run enterprises in a commercially viable way.

- Framework and initial financing for employee stock funds.

54

- TA to structure wide-spread offerings as a key component of the transaction structure.
- Framework for privatization trust/investment funds.

55

Annex D: Privatization of Telecommunications in Africa

I. *TELECOMMUNICATIONS PRIVATIZATION*

Telecommunications network facilities and basic services in sub-saharan Africa are arguably the worst in the world, with national penetration rates well below 1 main line per 100 inhabitants. In Zambia, for example, one of the long-term network expansion targets is 1 main line per 100 inhabitants by the year 2000. This is a stark contrast with developing countries in other parts of the world, such as Asia, where Indonesia and the Philippines find their current 1 line per 100 inhabitants unacceptable and embarrassing.

The major approach to improving network scope and performance worldwide is introduction of the private sector, through investment by a strategic (i.e., operating) partner, and privatization through initial public offering (IPO). Another form of privatization worth noting because of it application in Botswana is a management contract. For Africa, the strategic partner option is the most relevant because it brings in much needed management expertise and capital. An IPO is appropriate for countries with developed infrastructure and capital markets since the primary benefits of an IPO include expanded ownership and access to equity financing. The management contract option has been successful in supporting network planning, but this mechanism generally fails to bring new capital, is less attractive to private companies than taking an equity stake in the company, and leaves some question as to how the company will be managed after the contract expires.

Although the strategic investor option is the most conducive to infrastructure development and therefore most appropriate for Africa, there are several ways to tailor this model to the needs of specific countries. First, an IPO may be implemented after investment by a strategic partner. Through the IPO, the government will offer some of its remaining shares in the company to the public, with the benefits of spreading ownership, supporting capital markets, and enabling the government to profit from post-privatization increases in the value of the company. A second option is to allocate a block of shares for employee ownership at the same time a block is sold to a strategic investor

A. *Privatization through Investment by a Foreign Operator*

There are three major obstacles to privatization with a foreign investor: legal, political and investor willingness. Legal obstacles to foreign direct investment are implemented at the economy-wide level and effect the telecommunications sector. These include cumbersome investment licensing procedures, requirements that foreign investors form joint ventures with domestic firms (Mozambique), high import duties (Zambia), tax structures penalizing foreign businesses (Southern Africa Customs Union and Preferential Trade Area countries), and currency and repatriation restrictions.

-56

Political obstacles to telecommunications privatization are to a certain extent misconceptions. Privatization opponents frequently cite national security as an argument against foreign participation in telecommunications and other infrastructure sectors. In practice, foreign ownership of telecommunications facilities is not a threat to national security, since military organizations tend to maintain their own networks and concession agreements can include the right for a government to assume control of the network during times of civil strife. Another common misconception is that privatization means 100% sale to foreigners. Although private investors must have managerial control of the company, in virtually all privatized companies the strategic investor holds less than 50% of the shares.

The more compelling political considerations are emotional. Africans (especially in South Africa, Zimbabwe, and Zambia) are sensitive to "economic colonialism", which refers to foreign trade without investment. The perception that a European or American operator was profiting from a telecommunications system which is a natural resource is politically untenable in most African countries. In fact, it is widely held that as telecommunications is a strategic industry it should be owned nationally, with profits from the sector being reinvested in the local economy. A final emotional argument, particularly relevant to Zimbabwe, where land disputes threatened the future of aid programs, is the role of donor agencies in the privatization process. Widespread donor support for privatization positions it as a threat to national autonomy, and government decision makers (i.e., politicians) do not want their decisions to be viewed as attempts to placate the donor community.

A final obstacle to privatization in Africa is lack of investor interest. There are a plethora of opportunities in telecommunications in wealthier parts of the world, including Western Europe, Southeast Asia, and former Soviet bloc countries. African geography and demographics are relatively unattractive to potential investors, as telecommunications is most profitable where there are high population densities and investors are most comfortable close to home (or regional headquarters). Finally Africa is associated with both real and perceived political instability which is frightening to investors. Competition for investment is a threat to any country and the investment-seeking countries of Central and Latin America are both closer (geographically and culturally) and more hospitable to foreign investors than is Africa.

In short, it may appear that the Africans do not want foreign investors and the foreign investors do not want to be in Africa. This oversimplification, however, fails to consider the fact that Africans do want rapid achievement of the objectives best achieved through foreign strategic investment and that operators around the world facing market saturation and competitive pressures at home are looking for investment opportunities overseas. There is some evidence that foreign investment obstacles are beginning to dissipate. Foreign investment in cellular telephone systems in Zaire, Tanzania, and Zambia, for example, either exists now or will be implemented soon.

B. *Domestic Participation in the Sector*

It could be argued that some of the obstacles described above would not apply if the strategic investor was local rather than foreign. Privatization through sale of a portion of the company to a domestic strategic investor, however, is unprecedented in the telecommunications sector. The concept of a strategic investor requires that the investor have operational experience and expertise. In countries where the national network is operated by a state owned telecommunications company, there would be no experienced private sector operator to serve as investor. No domestic private sector investor/operator could offer the benefits of a foreign operator, including managerial improvement, purchasing leverage with suppliers, training opportunities including access to foreign facilities and rotation of experienced personnel, and access to international capital markets to raise capital. A final drawback of a local investor is that the links between business and government are very close, and Africans have expressed suspicion about the transparency of privatization processes and ongoing operations.

There are, however, avenues for the domestic private sector participation in telecommunications, most prominently through IPOs. This mechanism of including the domestic private sector is common in Latin America, where privatized companies which are publicly traded include ENTEL of Chile, CTC of Chile, Telefonica de Argentina and Telecom Argentina, and Telmex. An IPO for CANTV of Venezuela is currently being planned. There are two major obstacles to an IPO component in Africa:

- An IPO requires an active, well capitalized local stock market. Many African countries do not have the stock exchange or capitalization to absorb a large offering, such as a telecommunications company IPO.

- Because an IPO would tend to be politically more popular than a strategic investor, there would be a temptation to do the IPO first. This situation would be damaging to both transactions. Because the strategic investor is expected to add value, share prices after the strategic investment would be higher than before; thus IPO proceeds would be greater after a strategic investment. Conversely, if a strategic investor were introduced after an IPO, the market would bid up the purchase price of the company in anticipation of the benefits the strategic investor would bring, making the deal much less attractive to strategic investors.

A final option for including the domestic private sector in a telecommunications privatization is through employee stock option plans (ESOPs). Like the IPO, this mechanism can also be combined with a strategic investor to promote domestic ownership and help overcome the obstacle of union opposition to privatization. Labor unions fear loss of influence and negotiating leverage with a private owner, and therefore oppose privatization.

58

C. *Steps to Privatization*

Prerequisites for telecommunications privatization generally include the following activities:

- **Legislative Changes.** State-owned telecommunications companies were frequently created by laws providing sole right to run telecommunications facilities to the state-owned company. One of the early steps in privatizing is to amend the national telecommunications law so that it enables the operating environment to be implemented.

- **Regulatory Framework.** Telecommunications liberalization generally means moving from a monopoly environment to one of limited competition. In order to protect the competitive environment, promote sector development, and avoid abuse of remaining monopoly power, a regulatory structure must be put in place. The regulatory structure must be transparent and well defined, independent of the political process, and independent of operating companies to be effective, especially if private sector involvement is to be fostered. Key regulatory decisions include introduction of competition, interconnection obligations, and rate-making mechanisms.

- **Corporate Restructuring/Commercialization.** In most Southern African nations, telecommunications grew as an appendage to the postal department. Many countries are in the process or have just completed the process of separating the postal and telecommunications companies. Countries in which a single company still operates both posts and telecoms include Swaziland and Zimbabwe. As part of preparation for privatization, the separation of posts and telecoms must occur and the companies must be commercialized through implementation of effective accounting, management information systems, and human resources policies.

- **Development of Privatization Strategy and Criteria.** A privatization will ultimately require a concession agreement and management contract to further define the operating rules of the sector. Key privatization strategy decisions include the percentage of ownership to be transferred to the public sector, possible retention by the Government of a "Golden Share" and identification of rights associated with that share, period of exclusivity post privatization, and lines of business to be operated by the company. Defining privatization criteria requires identifying network expansion and service quality targets, and requirements for the potential buyers. These decisions must be made early on in the process to allow for legislative implementation where necessary.

Although these preliminary activities may meet with some resistance, they are not, in and of themselves, obstacles to privatization, as evidenced by privatizations around the world in which these actions were taken.

Some countries within Southern Africa have begun the privatization process, through actions such as:

- establishment of a telecommunications regulatory entity in Mozambique;

59

- separation of posts and telecommunications into separate operating companies owned by a common parent in Namibia;

- pending separation of posts and telecommunications and establishment of a regulator in Zambia;

- implementation of a management performance contract and upcoming separation of posts and telecommunications in Swaziland;

- licensing/implementation of private sector cellular companies in Tanzania and Zaire; and

- upcoming policy forum on telecommunications privatization in Zimbabwe.

-60